Key Note

Commercial Dynamics in Financial Services

2001 Market Assessment

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Edited by Simon Taylor

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Key Note

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INTRODUCTION

Commercial Dynamics in Financial Services is Key Note's analysis of the forces which are continually reshaping the financial services industry: competitive pressures and political imperatives, changing market demands, technological opportunities, the power of brands, and the rise of strategic partnerships. 'Financial services' are cash management, savings, investments, loans, credit cards, mortgages, and long- and short-term insurances.

COMPETITIVE PRESSURES AND POLITICAL IMPERATIVES

HSBC is the UK's biggest bank. Its profits in 2000 dwarfed those of all other banks in the UK. Lloyds TSB, Barclays and Royal Bank of Scotland follow HSBC in terms of pre-tax profits. The banks fared much better than the insurers in 2000: long-term insurance was hit by the public's reluctance to invest in pensions and endowments because of falling returns, and general insurance was hit by rising claim values. Royal & Sun Alliance, for example, achieved a marginal profit, and CGNU posted a huge loss.

The Government halted Lloyds TSB's £17bn hostile bid for Abbey National, on the grounds that the takeover would be against public interest. The decision has far-reaching implications for domestic banks and insurers: during the lifetime of the current administration, 'public interest' is likely to prevent any mergers which concentrate more than around a quarter of any market in the hands of one company. Increasingly, therefore, companies will look to expand abroad. Lloyds TSB and Barclays both earn over 85% of their profits in the UK, and in recent years have grown by acquiring UK organisations, a process that will be difficult to continue because of the concentrated nature of UK financial services. Halifax and Bank of Scotland are expanding through a merger with each other, but when this is accomplished, further growth by acquisition or merger will be hard to come by. Further details and figures are given in Chapter 2 — Strategic Overview, and Chapter 11 — Company Profiles.

The leaders of the UK's financial services industry are extremely well rewarded, especially at HSBC, Barclays, and Royal Bank of Scotland. Shareholders are trying to exert more control over salaries, bonuses and fees. Typically, chief executives of large financial companies received well over £500,000 in 2000. Further details are given in Chapter 6 — The Human Factor: Power in the Boardroom.

Overall weak growth, and a continued decline in manufacturing, are likely in the UK during 2001 and 2002. Rural industry is suffering from the impact of foot and mouth, exports to Europe are costly because the pound appreciated against the euro, and worldwide falls in share prices make corporate and private investors feel less wealthy. Less wealth means less demand for most financial services, with the exception of secured and unsecured credit. This is an important point for banks and insurers generally and, in particular, for those that are homing in on wealth management, including HSBC, Lloyds TSB and Barclays. Property should be more popular with the public than equity-based investments, until stockmarkets have settled down.

Between 1996 and 2026, a fall of 7.5% in the 30 to 44 prime working age band is expected, while there could be a rise of 76.6% in men aged 75 and over, and over 33% more women aged 75 and over. The forecast increases in the over-90s are even more striking: a near trebling of men over 90, and a rise of 57.5% in women nonagenarians. The elderly represent a substantial new market for financial services, especially for schemes to augment pensions. Further details are given in Chapter 9 — PEST Analysis.

CHANGING MARKET DEMANDS

The early UK entrants in the ‘senior citizens’ market were mainly foreign: NPI, owned by AMP of Australia; GE Life, part of General Electric of the US; Sun Life, part of the French AXA group; and Cornhill, part of Allianz of Germany. It is surprising that these companies were so much quicker than most domestic companies to see a market opportunity. In the important personal pensions sector, the bombshell dropped by Equitable Life on 16th July 2001 — when it slashed its with-profits funds by 16% — is likely to have far-reaching repercussions. This serious example of dashed expectations is likely to reduce public interest in stakeholder pensions, for which the Government so much wants the majority of adults to save. The Government now needs to rethink. Some form of state guarantee is required to underpin savings for personal pensions.

The increasing financial pressures on ‘middle Britain’ may translate into a new demand for mutuals and co-operative organisations. The Nationwide, the Chelsea and the other surviving building societies all emphasise the advantages of mutuality for customers.

Banks that invest in environmentally dubious projects, such as oil drilling in Alaska, or tree clearance in the Amazon basin, will face more critical public scrutiny. The ethical indices, FTSE4Good, launched in London in July 2001, are a significant move, because they reflect public worries about investments that could harm people or the environment.

Further explanations of all these issues are given in Chapter 12 — The Future.

TECHNOLOGICAL OPPORTUNITIES

Customers are getting used to the disappearance of branches, and are quickly accepting online banking — except the less affluent. Call centres need improvement because they are often not at all user-friendly. The elderly, especially, often find product information confusing, so it would be a good idea for companies to present essentials in clearer language. Consumer research indicates that insurers will have difficulty in expanding the domestic market profitably, and that huge damage has been done to the pensions business. Flexible all-in-one accounts, which can link cash, mortgages and personal loans, have very quickly become popular. Credit and credit management will remain growth sectors, as customers prefer today's tangibles to tomorrow's uncertainties. Further details are provided in Chapter 4 — Cost-Cutting Pressures, and Chapter 10 — Consumer Dynamics.

THE POWER OF BRANDS

Mergers and acquisitions create branding problems. HBOS (Halifax Bank of Scotland) is very similar to HSBC (Hong Kong & Shanghai Banking Corporation). Royal & Sun Alliance is perhaps too long a name to retain, as is CGNU which has now opted to use the respected Norwich Union brand in the UK. Barclays has so far retained the Woolwich brand, and Royal Bank of Scotland has kept National Westminster. The use of multiple brands gives the public an illusion of choice, because only those who closely follow the financial news can really appreciate who owns whom.

Brand development is becoming a big headache because of fragmentation of promotion channels, audiences and messages. The straightforward advertisement has lost its impact. Brand development now needs to be integrated across many channels in order to build and reinforce the message. Further details of brand development and multiple brands are given in Chapter 7 — Promotion and Advertising.

The combination of branch closures and the growth of call centres suggests that staff are now more remote from customers. The growing lack of familiarity between staff and customers results in the rise of control measures which can reduce customers to a set of numbers. Companies which are keen to rebuild links between staff and customers include Bradford & Bingley, with its financial advisers; Abbey National with the coffee-shop-bank concept; and Alliance & Leicester with its 'movingimproving' finance shops. These former building societies appear closer to customers than the big banks do. Chapter 4 — Cost-Cutting Pressures gives more details.

THE RISE OF STRATEGIC PARTNERSHIPS

Partnerships enable companies to expand without creating obvious monopolies. In May 2001, five banks from five nations — Barclays of the UK, Deutsche Bank of Germany, Bank of America, Scotia Bank of Canada, and Westpac of Australia — joined forces to create a global ATM (automated teller machine) alliance, so that 36 million customers can take out cash, without being charged, from 23,000 ATMs. Partnerships have been used with notable success by Royal Bank of Scotland, helping to make it into an international bank, and by Bank of Scotland, to maintain its status as a leading national bank. Chapter 5 — The Partnership Web discusses partnerships in greater detail.

1. Introduction

THE TOPIC

Commercial Dynamics in Financial Services is Key Note's analysis of the forces which are continually reshaping the financial services industry: competitive pressures, changing market demands, political imperatives, technological opportunities, the power of brands, and the rise of strategic partnerships.

Key Note believes that the topic is important for the following reasons:

- Globalisation and the operations of multinationals are topical political issues, raising questions about democratic accountability.
- Consumers need to understand the competitive structure of the industry if they are to make informed financial decisions.
- Competitive pressures encourage companies to concentrate on their highest-margin customers, making it increasingly difficult for low-margin customers — at least, those who are not of crucial importance to the Government — to find reputable suppliers of financial products. Increasingly, these are middle earners, those who do not have wealth for banks to manage, and who are not socially excluded.

OBJECTIVES

This report aims to provide a snapshot of the financial services industry in summer 2001, focusing on the UK but in the context of the increasing globalisation of banking and finance. It also aims to highlight the important forces that will change the industry's structure in the first half of the decade 2000 to 2009.

METHODOLOGY

Themes that emerged in the recent reports on financial services have been explored further to review the changing structure of the financial services industry, and to investigate the forces acting upon it. Key Note has drawn extensively on companies' annual reports and published notices.

ORIGINAL RESEARCH

Key Note has drawn on data from previous NOP surveys on financial issues. However, a consumer survey was not specifically commissioned for this report because of its focus on the analysis of companies' actions.

PROBLEMS IN THE RESEARCH PROCESS

Companies keep their business development strategies confidential for as long as possible, to prevent others moving in and copying their ideas. Much of the analysis relies, therefore, on inferences drawn from previous actions, current data, and the context in which companies are operating.

DEFINITION

Commercial dynamics are the forces shaping companies' business plans. They include political, economic, social and technological factors.

By 'financial services', Key Note means cash management, savings, investments, loans, credit cards, mortgages, and long-term and short-term insurances.

2. Strategic Overview

LEADING UK BANKS AND INSURERS

Pre-Tax Profits

HSBC's profits in 2000 dwarfed those of all other banks in the UK — £6.54bn. The banks fared much better than the insurers. Royal & Sun Alliance achieved a marginal profit, and CGNU posted a loss of £1.41bn.

Table 1 shows the leading banks and insurers ranked by their pre-tax profits. HSBC is followed by Lloyds TSB, Barclays and Royal Bank of Scotland.

Halifax and Bank of Scotland, merging to form HBOS, would rank fifth by pre-tax profits and market capitalisation.

Table 1: Leading UK Banks and Insurers Ranked by Pre-Tax Profits at Latest Reporting Year (£m and %), 2000

	Pre-Tax Profits (£m)	Market Capitalisation at End of Reporting Year (£m)	Ratio of Pre-Tax Profits to Capitalisation (%)
HSBC	6,544	91,292	7.2
Lloyds TSB	3,886	39,535	9.8
Barclays	3,496	34,437	10.2
Royal Bank of Scotland	3,373	42,370	8.0
Abbey National	1,975	17,452	11.3
Halifax	1,715	14,909	11.5
Tesco†‡§	1,054	18,197	5.8
Bank of Scotland‡	981	9,845	10.0
Prudential	947	21,340	4.4
Legal & General	498	9,500	5.2
Alliance & Leicester	447	3,430	13.0
Sainsbury's†‡§	434	7,434	5.8
Northern Rock	250	1,820	13.7
Marks and Spencer†‡§	146	7,627	1.9
Royal & Sun Alliance	55	8,222	0.7
CGNU	-1,406	24,357	-5.8

Table continued overleaf...

Table 1: Leading UK Banks and Insurers Ranked by Pre-Tax Profits at Latest Reporting Year (£m and %), 2000

...table continued from previous page

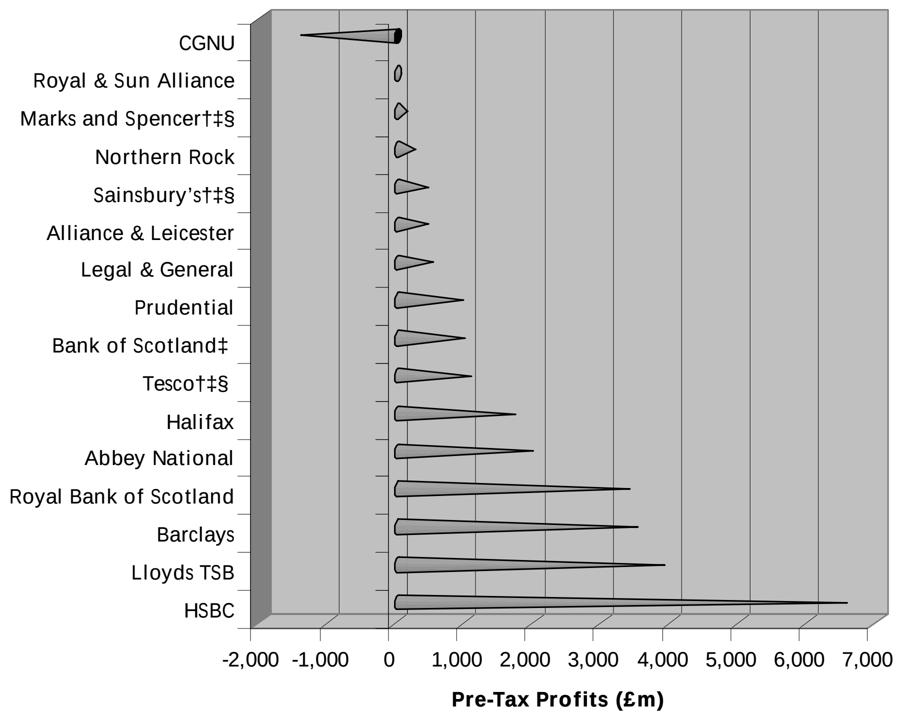
† — retailers with major interests in personal finance

‡ — 2000/2001

§ — whole company

Source:Company reports/Hemmington Scott/Key Note

Figure 1: Leading UK Banks and Insurers Ranked by Pre-Tax Profits at Latest Reporting Year (£m), 2000



† — retailers with major interests in personal finance

‡ — 2000/2001

§ — whole company

Source:Company reports/Hemmington Scott/Key Note

Pre-Tax Profits to Market Capitalisation

When the companies are ranked by their ratio of pre-tax profits to market capitalisation at the end of the latest full reporting year, the former building societies Northern Rock and the Alliance & Leicester emerge as the most under-valued, followed by the Halifax, also a former building society. The merged insurer Royal & Sun Alliance was the most over-valued, apart from fellow merged insurer CGNU which returned a loss. There is a general trend for the former building societies to be under-valued in relation to pre-tax profits, and for the insurers to be over-valued. Of course, pre-tax profits are only one measure on which a company's worth is based, but, as a general rule, shareholders place more confidence in, and accept lower returns from, well-established companies with global reach than they do from second-tier national companies.

Table 2: Leading UK Banks and Insurers Ranked by Ratio of Pre-Tax Profits to Market Capitalisation at Latest Reporting Year (£m and %), 2000

	Pre-Tax Profits (£m)	Market Capitalisation at End of Reporting Year (£m)	Ratio of Pre-Tax Profits to Capitalisation (%)
Northern Rock	250	1,820	13.7
Alliance & Leicester	447	3,430	13.0
Halifax	1,715	14,909	11.5
Abbey National	1,975	17,452	11.3
Barclays	3,496	34,437	10.2
Bank of Scotland‡	981	9,845	10.0
Lloyds TSB	3,886	39,535	9.8
Royal Bank of Scotland	3,373	42,370	8.0
HSBC	6,544	91,292	7.2
Tesco†‡§	1,054	18,197	5.8
Sainsbury's†‡§	434	7,434	5.8
Legal & General	498	9,500	5.2
Prudential	947	21,340	4.4
Marks and Spencer†‡§	146	7,627	1.9
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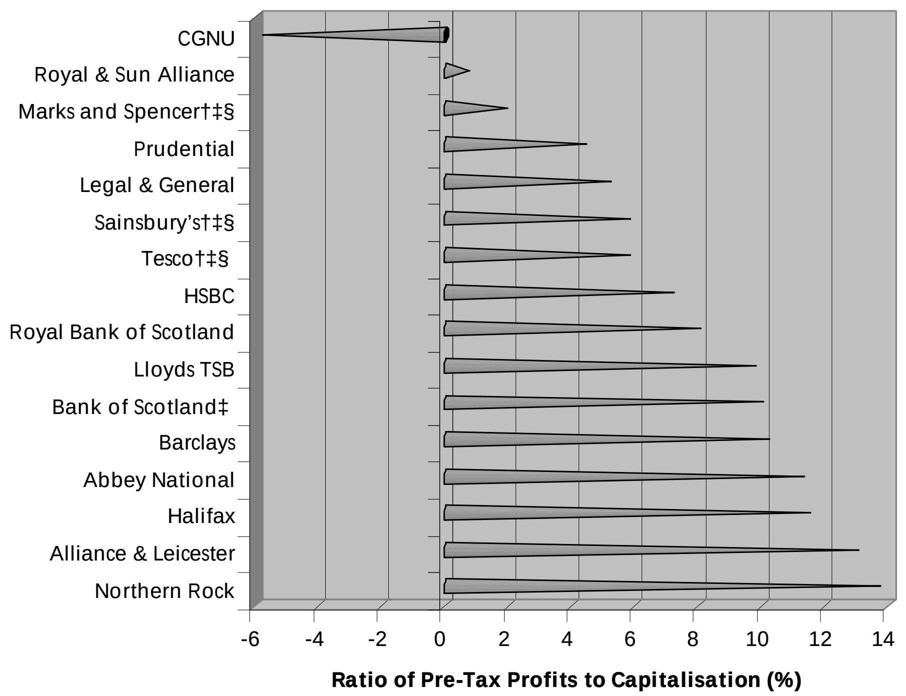
Figure 2: Leading UK Banks and Insurers Ranked by Ratio of Pre-Tax Profits to Market Capitalisation at Latest Reporting Year (%), 2000



† — retailers with major interests in personal finance

‡ — 2000/2001

§ — whole company

Source:Company reports/Hemmington ScottKey Note

Changes in market value relative to the latest end-of-year results are evident in Table 3. Overall, the financial services sector has seen a weakening of its stockmarket position since the end of 2000, as over-valued companies see their share prices slip. This has happened particularly to the big insurers: CGNU, Prudential, Royal & Sun Alliance and Legal & General. HSBC's value has been quite severely hit by investors' fears of problems in its key Far Eastern markets. Barclays is holding level. Alliance & Leicester, Northern Rock, and the merger partners Halifax and Bank of Scotland, have outshone Abbey National, Lloyds TSB and Royal Bank of Scotland.

Investors see few easy opportunities for these banks to improve profitability through growth. Abbey National has had its attention focused on the unwelcome, and now dead, bid from Lloyds TSB — whose own investors did not see much potential in the addition of Abbey National to the group. Royal Bank of Scotland has expanded rapidly from a staid Scottish institution to become a diversified financial conglomerate. Future growth at a similar rate will be difficult to achieve, but the Mellon purchase in the US, announced in July 2001, shows that it has no intention of stagnating.

Table 3: Leading UK Banks and Insurers Ranked by Ratio of Pre-Tax Profits† to Market Capitalisation (£m and %), 2000/2001

	Pre-Tax Profits† (£m)	Market Capitalisation at 6th July 2001 (£m)	Ratio of Pre-Tax Profits to Capitalisation (%)
Abbey National	1,975	17,089	11.6
Alliance & Leicester	447	3,949	11.3
Lloyds TSB	3,886	37,228	10.4
Barclays	3,496	34,470	10.1
Northern Rock‡	250	2,536	9.9
Halifax	1,715	17,811	9.6
Bank of Scotland §	981	10,665	9.2
HSBC	6,544	75,762	8.6
Royal Bank of Scotland	3,373	40,637	8.3
Legal & General	498	8,470	5.9
Tesco	1,054	18,105	5.8
Prudential	947	16,658	5.7
Sainsbury's	434	8,457	5.1
Marks and Spencer	146	7,428	2.0
Royal & Sun Alliance	55	7,596	0.7

Table continued overleaf...

Table 3: Leading UK Banks and Insurers Ranked by Ratio of Pre-Tax Profits† to Market Capitalisation (£m and %), 2000/2001

...table continued from previous page

CGNU	-1,406	21,273	-6.6

† — at latest reporting year

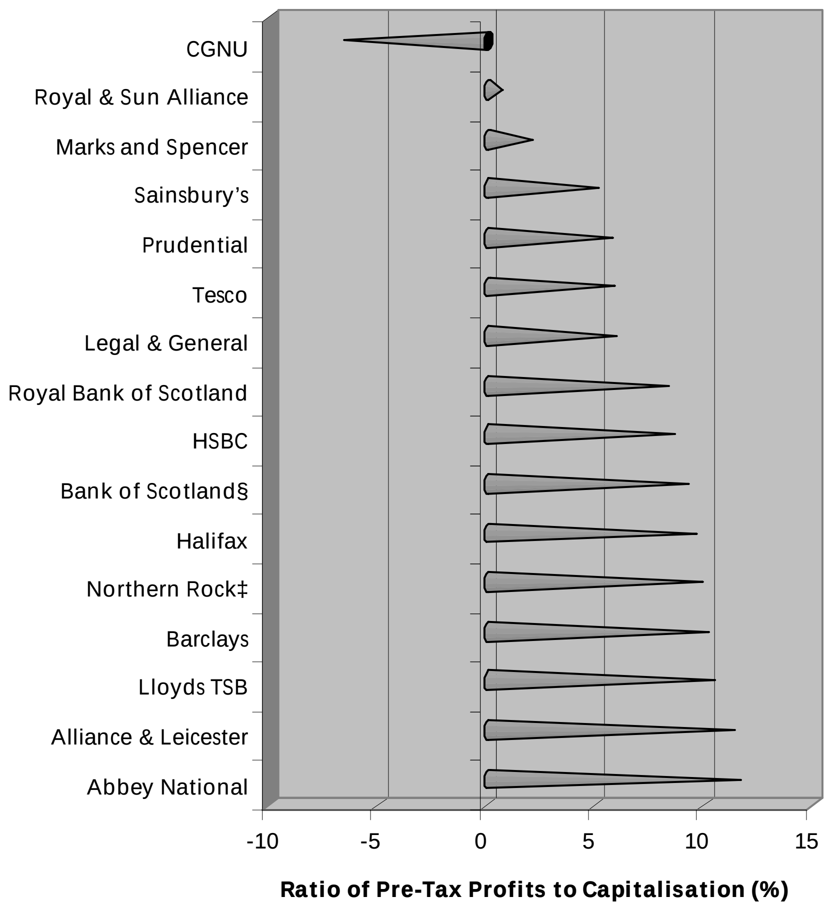
‡ — market capitalisation at 11th July 2001

§ — pre-tax profits for 2000/2001

Note: Tesco, Sainsbury's and Marks and Spencer are retailers with major interests in personal finance; figures are for 2000/2001 for whole company

Source:Company reports/Hemmington Scott/Key Note

Figure 3: Leading UK Banks and Insurers Ranked by Ratio of Pre-Tax Profits† to Market Capitalisation at 6th July 2001 (%), 2000/2001



† — at latest reporting year

‡ — market capitalisation at 11th July 2001

§ — pre-tax profits for 2000/2001

Source:Company reports/Hemmington Scott/Key Note

Pre-Tax Profits per Employee

Table 4 shows the leading UK banks and insurers by pre-tax profits per employee. Abbey National achieved the best profits per employee in 2000 — more than £63,000 — while, at the bottom of the table, CGNU lost more than £19,000 per employee. The big four banks — HSBC, Lloyds TSB, Barclays and Royal Bank of Scotland — all recorded pre-tax profits per employee of between £38,000 and £50,000, as did Bank of Scotland. Northern Rock's figure of over £58,500 places it third in the table.

The major retailers all operate on far smaller margins per employee than the banks. Among the insurers, Legal & General and Prudential achieved good levels of profit per employee, but Royal & Sun Alliance and CGNU did not. Three of the top four in the table have fewer than 10,000 employees, while the five companies with profits of less than £10,000 per employee all have over 50,000 staff.

Could we be entering a time when shareholders will look much harder at companies' expansion plans? Extra scale tends to result in less effective use of staff, but in larger payments to executives and directors, to compensate them for the extra difficulty of managing a large company. Perhaps there is a message here for Royal Bank of Scotland, which has paid its Chief Executive nearly £1.3m. However, the four companies heading Table 4 are all talked about as actual or possible bid targets. Abbey National has just escaped from being swallowed up by Lloyds TSB. The other three remain targets. This creates attractive propositions for short-term shareholders, who are buying into Alliance & Leicester and Northern Rock in the hope of gains when bids are made. But for the shareholders of the companies that do the bidding, big acquisitions may not be a sensible choice. Strategic partnerships, with different companies for different purposes, may be a more effective and flexible option.

Table 4: Leading UK Banks and Insurers Ranked by Pre-Tax Profits† per Employee (£m and £), 2000

	Pre-Tax Profits (£m)	Number of Employees	Pre-Tax Profits per Employee (£)
Abbey National	1,975	31,268	63,164
Legal & General	498	8,363	59,548
Northern Rock	250	4,270	58,548
Alliance & Leicester	447	8,854	50,486
Barclays	3,496	72,300	48,354
Bank of Scotland‡	981	20,933	46,864
Lloyds TSB	3,886	85,847	45,267
Prudential	947	21,942	43,159
Royal Bank of Scotland	3,373	83,300	40,492
HSBC	6,544	169,858	38,526
Tesco	1,054	152,210	6,925
Marks and Spencer	146	52,213	2,796
Sainsbury's	434	189,227	2,294

Table continued overleaf...

Table 4: Leading UK Banks and Insurers Ranked by Pre-Tax Profits† per Employee (£m and £), 2000

...table continued from previous page

	Pre-Tax Profits (£m)	Number of Employees	Pre-Tax Profits per Employee (£)
Royal & Sun Alliance	55	51,720	1,063
CGNU	-1,406	72,749	-19,327

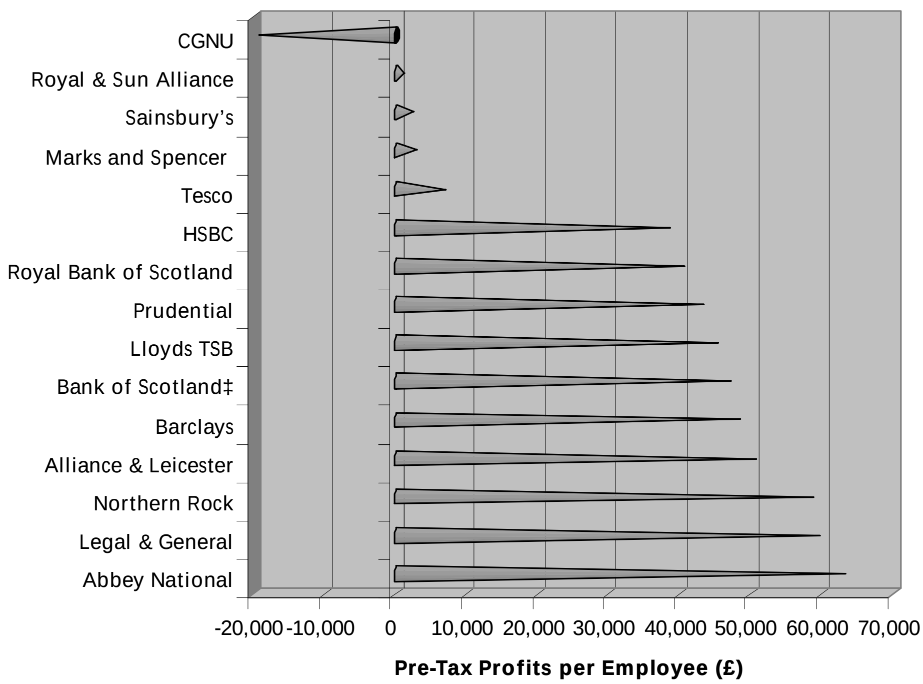
† — at latest reporting year

‡ — pre-tax profits for 2000/2001

Note: Tesco, Sainsbury's and Marks and Spencer are retailers with major interests in personal finance; figures are for 2000/2001 for whole company

Source:Company reports/Hemmington Scott/Key Note

Figure 4: Leading UK Banks and Insurers Ranked by Pre-Tax Profits† per Employee (£), 2000



† — at latest reporting year

‡ — pre-tax profits for 2000/2001

Source:Company reports/Hemmington Scott/Key Note

Dividend Cover

Dividend cover, the number of times that the dividend to shareholders could be paid out of earnings per share, indicates the likelihood of a company being able to pay a similar level of dividend in future years. The accepted threshold for acceptable cover is 2.0. The two large Scottish banks exceed this easily, but the big insurers seem likely to struggle to maintain dividend payments in coming years, especially if underwriting conditions do not revive dramatically. Of the remaining major banks, HSBC and Lloyds TSB have less dividend cover than Barclays and the Halifax.

Table 5: Leading UK Banks and Insurers Ranked by Dividend Cover† (pence), 2000

	Normalised Earnings per Share (pence)	Dividend per Share (pence)	Ratio Dividend Cover
Royal Bank of Scotland	110.0	33.0	3.33
Bank of Scotland‡	47.3	15.3	3.09
Northern Rock	45.4	15.5	2.93
Barclays	163.0	58.0	2.81
Halifax	62.9	26.5	2.37
Tesco‡	11.3	4.98	2.27
Alliance & Leicester	66.6	33.0	2.02
Abbey National	87.0	45.5	1.91
HSBC	52.7	29.1	1.81
Lloyds TSB	53.1	30.6	1.74
Sainsbury's‡	19.1	14.3	1.34
Legal & General	6.16	4.71	1.31
Marks and Spencer‡	11.4	9.0	1.27
Prudential	25.9	24.5	1.06
Royal & Sun Alliance	-12.6	26.0	-0.48
CGNU	-71.7	38.0	-1.89

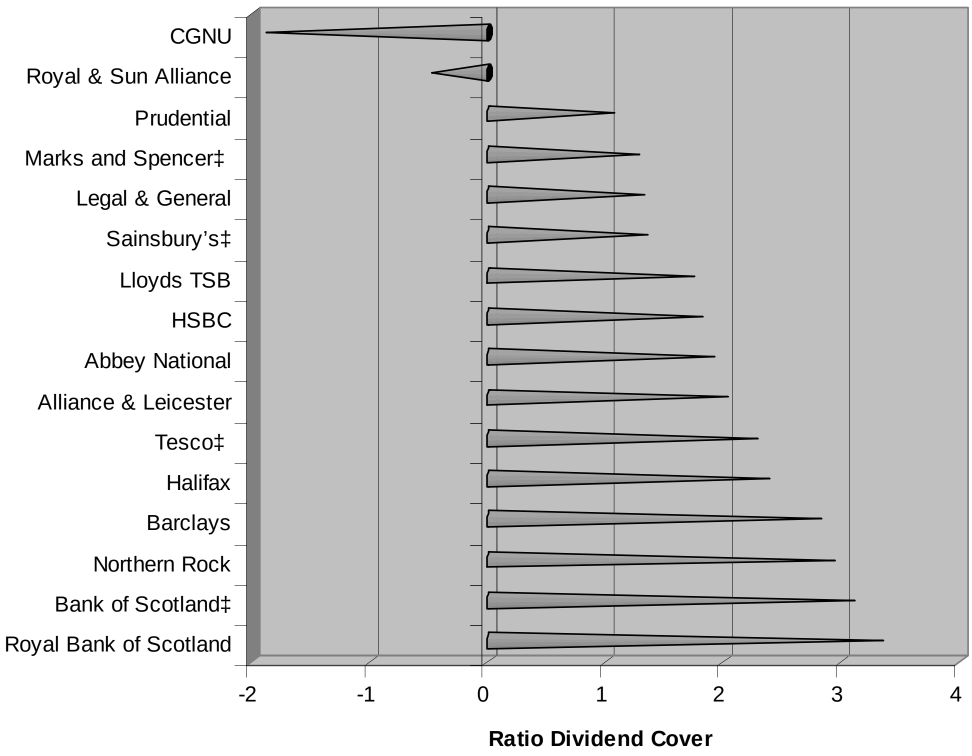
† — latest reporting year

‡ — 2000/20001

Note: Tesco, Sainsbury's and Marks and Spencer are retailers with major interests in personal finance

Source:Company reports/Hemmington Scott/Key Note

Figure 5: Leading UK Banks and Insurers Ranked by Dividend Cover†, 2000



† — latest reporting year

‡ — 2000/20001

Source:Company reports/Hemmington Scott/Key Note

Intangibles

Intangibles advanced rapidly in 2000, especially at Royal Bank of Scotland, where they rose from £11m to £12.08bn. Intangibles also rose substantially at Barclays and Lloyds TSB. Intangibles are problem children in balance sheets because their nature makes them very difficult to value accurately.

Table 6: Leading UK Banks and Insurers Ranked by Increase in Intangibles† (£m and %), 1999-2000

	1999	2000	% Change 1999-2000
Royal Bank of Scotland	11	12,080	109,718.2
Barclays	183	4,269	2,232.8
Lloyds TSB	231	2,599	1,025.1
CGNU	191	747	291.1
Bank of Scotland‡	760	192	-74.7
HSBC	4,379	10,101	130.7
Halifax	420	951	126.4
Abbey National	203	245	20.7
Tesco	136	154	13.2
Royal & Sun Alliance	1,035	1,086	4.9
Prudential	1,582	1,611	1.8
Alliance & Leicester	0	4	§
Sainsbury's	316	278	-12.0
Marks and Spencer	1	0	§
Legal & General	0	0	0
Northern Rock	0	0	0

† — at latest reporting year

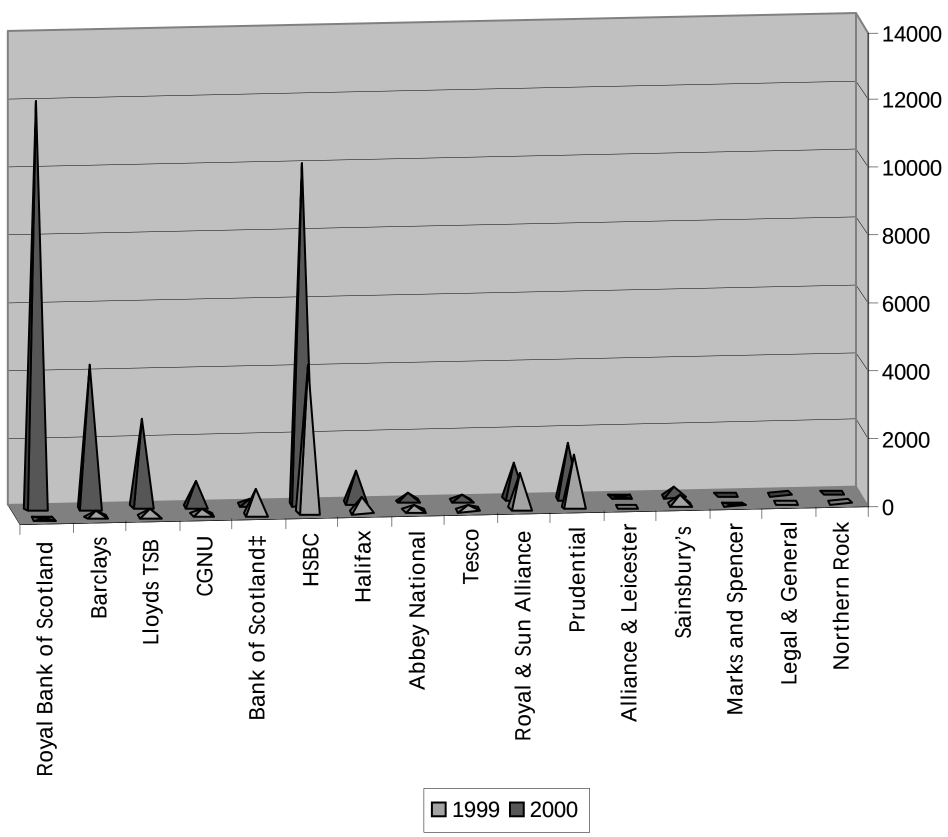
‡ — 2000/2001

§ — calculation is invalid, because the figures move either from positive to negative or from negative to positive

Note: Tesco, Sainsbury's and Marks and Spencer are retailers with major interests in personal finance

Source:Company reports/Hemmington Scott/Key Note

Figure 6: Leading UK Banks and Insurers Ranked by Increase in Intangibles† (£m), 1999-2000



† — at latest reporting year

‡ — 2000/2001

Source:Company reports/Hemmington Scott/Key Note

Mergers

The number of major banks in the UK is now about as low as it can be without endangering consumer choice. Bank of Scotland wanted to take over Abbey National, before opting for a merger with the Halifax. Lloyds TSB has been intent upon acquiring Abbey National, to leapfrog over Royal Bank of Scotland and reduce the gap with the UK's largest banking group, HSBC. The Department of Trade and Industry (DTI) accepted the Competition Commission's recommendation to refuse the takeover, while this report was being prepared. There are not many medium-sized fish left swimming in the pool.

The big insurers have already gone down the mega-merger route without startling success. CGNU, which lost over £1.4bn in 2000, is made up of Commercial Union and General Accident, which combined as CGU in 1998, and then added Norwich Union in 2000. The Royal and Sun Alliance companies merged in 1996 but have not yet forged a unique new identity.

Between May 1997 and May 2000, there were two other major insurance mergers in the UK: AXA Equity & Law with Sun Life & Provincial Holdings in May 1997, to form AXA Sun Life, and GAN with Lombard General in April 2000 to create Groupama. The same 3 years saw 18 major takeovers, including, just in 2000, Churchill buying NIG, Royal London acquiring United Assurance, AEGON taking over Guardian Assurance, and Lloyds TSB absorbing Scottish Widows.

3. The Scramble for Growth

INTERNATIONAL DOMINANCE

The feeding frenzy among financial services companies worldwide echoes that among grocery retailers, which are further up the cycle. As yet, no bank is the global equivalent of Wal-Mart, but the main contenders are all aiming for international dominance.

The next phase of the retail cycle may well indicate what could follow in financial services. For how long can Wal-Mart continue expanding? How dominant will Tesco become in the UK? Will political opposition to mega companies grow? Will shoppers become tired of the same brand names?

The Department of Trade and Industry's (DTI) decision, in July 2001, to block Lloyds TSB's takeover of Abbey National, shows that there is indeed political opposition to commercial gigantism, which could force companies to forge partnerships rather than buy each other up. CGNU, the overweight insurer, is treading this path in France with its plans for a partnership with MMA/MAAF.

HSBC, the UK's largest bank, has a euroland platform with Crédit Commercial de France, but is concentrating on acquisitions in rapidly developing nations including the Philippines, Latin America, China and India. Royal Bank of Scotland, now the UK's second bank, has a very different focus for expansion: the US, where the bank owns Citizens, the second largest bank in New England, and, at the time of writing, was about to acquire the retail arm of Mellon Banking Corporation.

HSBC is expanding in private banking in the US, for example, with Republic New York Corporation, but Royal Bank of Scotland is going much more deliberately for mass-market financial services in the US. Royal Bank's strategy should carry less risk than that of HSBC, because loan defaults and developing economies often go hand in hand. HSBC has successfully reduced its bad debt charges, from $2.64bn in 1998 to $932m in 2000 — 3.5% of gross advances to customers — and so may be controlling risks more effectively.

Lloyds TSB and Barclays both earn over 85% of their profits in the UK, and in recent years have grown by acquiring UK organisations, a process difficult to continue because financial services in the UK are now so concentrated. Halifax and Bank of Scotland are expanding through a merger with each other, but when this is accomplished, further growth by acquisition or merger may be hard to come by.

Conventional wisdom has long been that organisations either grow or contract. Shareholders want more value, not less, so aiming for growth is generally companies' only practicable option.

Financial services prosper in well-regulated free-market economies, where there are now few niches left for newcomers to fill. Political considerations will be critical: by refusing to allow certain mergers and acquisitions, governments will help organisations to retain their independence. In the UK, political limits to domestic expansion will force Lloyds TSB, Barclays, CGNU and Prudential to diversify geographically or into different commercial sectors. Both Lloyds and the Prudential tried sector diversification when they moved into estate agency — and soon moved out again. Perhaps a few solid utilities — for example, water, gas, electricity — might provide an answer. Utility companies are not particularly exciting, but remain relatively safe, solid companies when compared to those in the e-commerce sector.

4. Cost-Cutting Pressures

HOW TO REDUCE COSTS

Companies' responses to cost pressures can be summed up as 'goodbye staff' — at least, in high-wage economies.

Greater central control is also a feature of companies under pressure, as they seek to ensure uniformity of service and product quality across the business — a task which becomes much harder as the business grows. Central control limits staff initiative and tends to make their jobs less interesting. Despite what companies' annual reports may say about flat management structures and the important role of the individual, technological advances mean that systems take over, and that there is less room for professional judgement. This applies in mortgage lending and in credit scoring generally, because the processes are automated.

Sharp attention to the bottom line can result in an organisation in which staff are always trying harder to achieve more for a lower outlay. This can work if staff share the organisation's goals, but this is harder to achieve as the organisation grows. The chances of, say, more than 100,000 staff all working away to generate maximum profits for their employer, are very remote. Thus, very large organisations often have to rely on control measures to achieve their business objectives.

As organisations grow, the gap between top and bottom salaries tends to widen, and directors become far more remote from the staff who actually meet customers. Shareholders may seek expansion and cost controls — apart, usually, from directors' fees — but customers like to deal with friendly, knowledgeable staff who know them, provide a good service and can solve any problems that crop up. In insurance, brokers can provide this service, but direct sellers are driving them out of business. In banking, personal relationships have nearly all gone, except for customers with substantial assets who opt for wealth management.

There are fewer staff in branches, because branch numbers have fallen so much, but this does not mean that staff numbers in banking have declined. On the contrary, in the first quarter of 1991, the total of 3,768,000 employees in banking and finance represents only 78.7% of the 4,784,000 employees in 2001. Staff have come out of branches and into call centres. The British Bankers Association says that the 17 major chains, representing ten banking groups, had 13,621 UK branches in 1995, but only 11,026 in 2000, a fall of 19.1% in 5 years. Call centres favour large companies. A centre with 100 work stations costs around £3m a year to run — £1.4m on wages, £450,000 on management, and £1.2m on the infrastructure. For further details, refer to Key Note's 2001 Market Assessment report *Call Centres.*

To take an example, Britannic's customer-service centre at Wythall Green, Birmingham, won the 'best use of technology' class in the National Customer Service Awards, 2000. Efficiency gains included processing times being 30% faster, staff productivity being 40% higher, and 80% of customers' queries being solved in one initial call. At Wythall Green, 150 agents were soon handling more than 20,000 calls a week, answering 95% of them within 15 seconds. Britannic illustrates the trends to integrate functions so that agents have access to database information, and to encourage agents to acquire more skills so that they can use some initiative when taking calls.

The combination of branch closures and the growth of call centres suggests that staff are now more remote from customers: fewer staff know customers as individuals. The growing lack of familiarity between staff and customers results in the rise of control measures which can reduce customers to a set of numbers.

Companies which are keen to rebuild links between staff and customers include:

- Bradford & Bingley, with its advisers.
- Abbey National, with the coffee-shop-bank concept — small at present, but it could grow.
- Alliance & Leicester, with its ‘movingimproving’ finance shops.

These are all former building societies.

Financial services organisations cannot look forward to a respite from cost-cutting pressures, but the adverse impact on customers could be eased by full integration of distribution channels.

5. The Partnership Web

THE RISE OF PARTNERSHIPS

Financial Services Partnerships Make Good Sense

The ideal times for selling financial services are not necessarily when customers are walking into their bank branch or sitting in front of the TV. Events such as buying a house or becoming a parent are triggers for mortgages and insurances, and so partnerships between financial services companies and estate agents, or children's retailers, make good sense.

Banking Partnerships

Bank of Scotland has many financial partners, including AXA and Royal & Sun Alliance for insurance, and Sainsbury's for supermarket banking. The bank's other partners include British Gas and Saga. The bank brings great experience of partnerships to its merger partner, Halifax.

Partnerships will become more common in the life and pensions sector, according to Forrester Research,[1] which sees the structure of the sector changing to 'a resilient structure of interdependent players, co-operating in real time over the Net'.

HSBC seems to prefer out-and-out acquisitions, but also works with other groups, for example, CGNU in the UK. HSBC also has a supermarket banking link with Morrisons.

Royal Bank of Scotland has established some famous partnerships — such as with CGNU, Tesco and Virgin — but as it grows more powerful, there are signs that it wants complete control; the whole of Virgin One, for example. The partnership with Banco Santander may be developed in Europe, perhaps in long-term savings when governments encourage these more actively.

Lloyds TSB has a new interactive TV partnership with Telewest, and with Goldman Sachs for wealth management.

Barclays has a strong link with Legal & General, which creates a full bancassurance offering for Barclays customers. The mobile phone banking deal with Vodafone shows Barclays' commitment to multichannel distribution, but at present the mobile-banking initiative is ahead of consumer demand. Barclays has set up Intelligent Processing Systems Ltd (IPSL) with Lloyds TSB and Unisys, to provide cheque-processing services, an example of a partnership to reduce costs. Towards the end of July 2001, Barclays announced plans for a significant move overseas, a proposed joint venture with Canadian Imperial Bank of Commerce for a new bank, First Caribbean International Bank. The potential Canadian link is not surprising because Barclays' Chief Executive, Matthew Barrett, came to Barclays from the Bank of Montreal.

1. *'Online pensions to shake up old order', MAD, 26th April 2001.*

Other Companies

CGNU is talking about a possible partnership with MMA/MAAF in France, where it already has a foothold in life insurance. CGNU already has ventures with banks in Spain, Italy and the US. Legal & General has partnerships with Alliance & Leicester and Northern Rock as well as with the larger Barclays, securing wide distribution in the UK.

In June 2001, Hitachi Credit's subsidiary Fleetlease agreed a partnership with Virgin Cars to be the sole provider of hire purchase and personal credit to car buyers at www.virgin.com/cars, the Virgin Group's online car-buying service, which sold over 5,000 cars in its first year. The service offers discounts of up to 30% on new cars, and ownership packages include discounts on servicing at franchised dealers.

Utilities and financial services are nothing new — for example, the Goldfish card launched by British Gas, now Centrica. During April 2001, Npower diversified into contents and building insurance, in a joint venture with brokers Jardine Lloyd Thompson, and intended to add other products during 2001, making the public aware of the increased range through direct mail, TV sponsorships and sponsorship of English cricket, and promotion in the electrical retailer Powerhouse.

In September 2001, Centrica is losing Goldfish to its partner in the operation, HFC, and the Goldfish database with it. With use of the electoral roll soon to be prohibited, it will be difficult for Centrica to rebuild the list.

In the credit-card sector generally, affinity cards are nothing new. Customers can choose credit cards which are co-branded with their club, school, university, car manufacturer or favourite charity. Financial services companies and retailers are linking up in cross-branding, like Egg and Boots with their joint credit card. This card, called the Advantage card, was given revised terms in spring 2001, because the mainly female users are more interested in special offers than in APR — so the interest rate rose from 10.9% to 12.9%, at a time when rates were generally in decline.

The Changing Web

The complex web of financial links and cross-links is constantly changing and thus impossible to reduce into print. CGNU has substantial shareholdings in other insurers and banks, including (as at late June/early July 2001) 3.41% of Royal Bank of Scotland, 3.06% of Legal & General, and 3.07% of Royal & Sun Alliance. Legal & General had 3.07% of Lloyds TSB, 3.03% of the Halifax and 3.01% of Bank of Scotland. The Prudential had 4.50% of Alliance & Leicester and 3.96% of Northern Rock. Barclays owned 3.87% of HSBC.

There are few substantial foreign shareholdings in the major British banks and insurers. Exceptions include the Hong Kong Monetary Authority's 4.01% of HSBC, the Spanish Banco Santander's 9.62% of Royal Bank of Scotland, the US's Fidelity with 5.22% of Northern Rock, and Deutsche Asset Management's 3.08% of Bank of Scotland. AXA of France has 3.70% of Legal & General and is the largest single shareholder.

Global Alliances

Partnerships span the world. To take just one example, Churchill Insurance of the UK, which is funded by Winterthur of Switzerland, has agreed with AMP of Australia to provide all general insurance for AMP's Pearl Assurance in the UK, retaining the Pearl brand name.

Five banks from five nations joined forces in May 2001 to create a global ATM alliance, so that 36 million customers can take out cash without charge from 23,000 ATMs. The banks are Barclays of the UK, Deutsche Bank of Germany, Bank of America, Scotia Bank of Canada, and Westpac of Australia.

Partnerships are of great value to second-tier companies which are anxious to grow, and have been used with notable success by Royal Bank of Scotland, helping to make it into an international bank, and by Bank of Scotland, to maintain its status as a leading national bank.

6. The Human Factor: Power in the Boardroom

HIGH REWARDS ON THE BOARD

The leaders of the UK's financial services industry are extremely well rewarded, especially at HSBC, Barclays, and Royal Bank of Scotland. The Chief Executive at Royal & Sun Alliance fared very well in 2000, considering the company's lacklustre performance.

The boards of the several big financial companies have similarities with exclusive gentlemen's clubs, with a small number of women dotted here and there as if to show that the companies are aware of 'equal opportunities'. Female directors are usually paid less than male ones, and on most boards are not at the 'top of the table'. HSBC is unusual in that it has a female deputy chair, Baroness Dunn DBE.

The argument is that leading British companies have to pay international salaries, to prevent the top business brains being poached overseas, or to attract business brains from abroad. Responsible jobs should attract good benefits. However, in companies with widely dispersed shareholdings, it is almost impossible for shareholders to exert any influence over payments to directors. The non-executive directors who sit on remuneration committees themselves benefit from high reward levels. Shareholders can show opposition to high rewards for directors of companies performing badly or indifferently, by selling their shares, but in the past this usually has had only a very minor influence on companies' market values because of the small numbers of shareholders who take this stand. Shareholders are now becoming more vocal in their opposition to payments which they believe are not fully merited.

Remuneration of Chief Executives and Chairpersons

Typically, chief executives of large financial companies received well over £500,000 in 2000. The highest paid was Matthew Barrett at Barclays. Most chairpersons received less than £500,000, but exceptions included Sir John Bond at HSBC, Sir Peter Middleton at Barclays, and John R Windeler at Alliance & Leicester, all of whom are executive chairpersons.

Table 7: Remuneration of Chief Executives and Chairpersons of Leading Financial Services Companies in the UK (£), 2000

	Annually (£)
Chief Executives	
HSBC	1,342,000
Royal Bank of Scotland	1,274,000
Lloyds TSB	856,000
Barclays	1,742,000
CGNU	815,000
Prudential	848,000
Abbey National	774,162
Halifax	690,000
Bank of Scotland	595,000
Legal & General	970,000
Royal & Sun Alliance	1,045,000
Alliance & Leicester	‡382,000
Northern Rock	559,000
Chairpersons	
HSBC (Executive Chair)	1,600,000
Royal Bank of Scotland	304,000
Lloyds TSB	488,000
Barclays (Executive Chair)	556,000
CGNU	246,000
Prudential	200,000
Abbey National	359,244
Halifax	265,000
Bank of Scotland (Governor)	199,000
Legal & General	160,000
Royal & Sun Alliance	175,000
Alliance & Leicester (Executive Chair)	808,000
Northern Rock	100,000

† — excluding share options and pension funds

‡ — half year

Note: figures relate to the company's latest reporting year; companies are ranked by market capitalisation

Source:Companies' annual reports

ACROSS THE BOARD POWER

HSBC

The board of HSBC, the biggest bank in the UK, illustrates the directors' roles as hubs in the webs of influence which connect industry and commerce worldwide. Connections with transport-related industries, especially in the Far East, are particularly evident on the HSBC board, as Table 8 shows. Directors have relatively few links with Continental Europe, apart from the Netherlands in the cases of Royal Dutch/Shell and Corus. The Marconi Directorship of Baroness Dunn, Deputy Chair, is none too helpful at present. The Marconi share price has collapsed in 2001.

Table 8: Major Directorships Held by Board Members of HSBC, 2000

	Directorship	Classification†
Sir John Bond (Chair)	Ford Motor Company	a
Baroness Dunn (Deputy Chair)‡	John Swire & Sons	a
	Swire Pacific	a
	Marconi	a
Sir Peter Walters (Deputy Chair)§	GlaxoSmithKline	b
K R Whitson (Chief Executive)	-	
Lord Butler§	Imperial Chemical Industries	b
R K F Ch'ien§	Inchcape	a
	MTR Corp	a
	chinadotcom Corp	e
D E Connolly‡	Kowloon-Canton Railway Corp	a
C F W de Croisset	-	
WRP Dalton	MasterCard Int	d
D G Eldon	Swire Pacific	a
	MTR Corp	a
D J Flint	-	
W K L Fung§	Li & Fing	e
S K Green	-	
S Hintze §	-	
A W Jebson	-	
Sir John Kemp-Welch§	-	

Table continued overleaf...

Table 8: Major Directorships Held by Board Members of HSBC, 2000

...table continued from previous page

	Directorship	Classification†
Lord Marshall§	British Airways	a
	Invensys	a
	British Telecommunications	a
C Miller Smith§	Imperial Chemical Industries	b
	Scottish Power	c
Sir Brian Moffat§	Enterprise Oil	c
	Corus Group	e
Sir Mark Moody-Stuart§	Royal Dutch/Shell Group	c
M Murofushi§	ITOCHU Corporation	e
C E Reichardt§	Ford Motor Co	a
	PG&E Corporation	c
	HCA-The Healthcare Co	e
	ConAgra Inc	e
	McKesson HBOC Inc	e
	Newhall Management Corp	e
H Sohmen‡	World-Wide Shipping Agency	a
	World-Wide Shipping Group	a
	World Maritime	a
	World Shipping & Investment Co	a
	World Finance International	d
Sir Adrian Swire§	John Swire & Sons	a
	Swire Pacific	
	Cathay Pacific Airways	a

a — transport/vehicles/electronics/communications/defence

b — chemicals/pharmaceuticals

c — oil/energy/utilities

d — finance

e — other

Table continued overleaf...

Table 8: Major Directorships Held by Board Members of HSBC, 2000

...table continued from previous page

† — companies are classified according to the dominant activity

‡ — non-executive director

§ — independent non-executive director

MTR Corp — Mass Transit Railway Corporation

Source:HSBC Annual Report

Royal & Sun Alliance

Royal & Sun Alliance has similar global ambitions to HSBC, but the directors have less experience — current experience, at any rate — with companies operating internationally. This is a disadvantage in the real world of global business.

Table 9: Major Directorships Held by Board Members of Royal & Sun Alliance, 2000

	Directorship	**Classification†**
Sir Patrick Gillam (Chair)‡	Standard Chartered	d
Anthony Forbes (Deputy Chair)‡	Merchant Trusts	d
	Carlton Communications	e
Bob Ayling ‡	-	
John Baker ‡	Celltech Group	b
Nicholas Barber‡	Fidelity Japanese Values	d
	bolero.net	e
Bob Gunn	-	
Julian Hance	-	
Arthur Hayes	Thistle Hotels	e
Stephen Hill ‡	Financial Times Group	e
Bob Mendelson	-	
Carole St Mark‡	Polaroid Corporation	a
	Gerber Scientific Incoporated	a
	Growth Management LLC	e
	SuperValu Inc	e

Table continued overleaf...

Table 9: Major Directorships Held by Board Members of Royal & Sun Alliance, 2000

...table continued from previous page

	Directorship	Classification†
Paul Spencer	-	

a — transport/vehicles/electronics/communications/defence

b — chemicals/pharmaceuticals

c — oil/energy/utilities

d — finance

e — other

† — companies are classified according to the dominant activity

‡ — non-executive director

Source:Royal & Sun Alliance Annual report

Royal Bank of Scotland

The board of the Royal Bank of Scotland, which has been by far the fastest growing bank in Britain, is steeped in finance. The executive directors bring experience from the constituent companies of the group, and the non-executives are very strong in fund management. Three of the board are also directors of Banco Santander — a very strong cross-link. The board combines deep financial experience with Scottishness: eight of the 18 have strong Scottish roots.

Table 10: Major Directorships Held by Board Members of Royal Bank of Scotland, 2000

	Directorship	Classification[†]
Viscount Younger of Leckie (Chair)	Banco Santander Central Hispano (Murrary Johnstone Investment Trust)	d
Sir Iain Vallance (Vice Chair)[‡]	British Telecommunications	a
Sir Angus Grossart (Vice Chair)[‡]	Noble Grossart	d
	Scottish Investment Trust	d
	Edinburgh Fund Managers	d
	Scottish & Newcastle	e
	Trinity Mirror Group	e
Sir George Mathewson	-	
Fred Goodwin	-	
Gordon Pell	-	
Iain Robertson	British Empire Securities & General Trust	d
Lawrence Fish	Textron Inc	a
Norman McLuskie	MasterCard	d
	Europay Int	d
	Worldpay Group	d
	Magex Holdings	e
Fred Watt	-	
Emilo Botin[‡]	Banco Santander Central Hispano	d
Juan Rodriguez Inciarte[‡]	Banco Santander Central Hispano	d
Eileen Mackay[‡]	-	
Cameron McLatchie[‡]	British Polythene Industries	b
Murray Stuart[‡]	Intermediate Capital Group	d
	CMG	e
	Capital Group	d
	Old Mutal	d
Bill Wilson	Edinburgh US Tracker Trust	d
	First American Title Insurance Co	d
	Scottish Rugby Union	e

Table continued overleaf...

Table 10: Major Directorships Held by Board Members of Royal Bank of Scotland, 2000

...table continued from previous page

	Directorship	Classification†
Bob Scott‡	GNCU	d
Peter Sutherland‡	BP Amaco	b
	Goldman Sachs International	d

a — transport/vehicles/electronics/ communications/defence

b — chemicals/pharmaceuticals

c — oil/energy/utilities

d — finance

e — other

† — companies are classified according to the dominant activity

‡ — non-executive director

Source:Royal Bank of Scotland Annual report

Royal Bank of Scotland directors are more international and more financially-oriented than the Barclays board.

Barclays

The well-paid directors at Barclays have connections with companies that are overwhelmingly British rather than global — large, but mainly serving the UK market. They are very light on background in transport, vehicles, communications, electronics and defence, and strong on retailing, pubs and restaurants, and property. Four do have long experience in the financial world. Matthew Barrett came from the Bank of Montreal in Canada, and the Executive Director John Stewart and Non-Executive Sir Brian Jenkins came from the Woolwich. Sir Andrew Large was at Swiss Bank Corporation between 1980 and 1990. Mr Barrett brings experience of banking in North America, an added dimension for Barclays. Sir Andrew Large was Chair of the Securities and Investment Board between 1992 and 1997. Barclays Chair Sir Peter Middleton was Permanent Secretary at the Treasury between 1983 and 1991, so he provides a strong connection with the ‘establishment’.

Table 11: Major Directorships Held by Board Members of Barclays, 2000

	Directorship	Classification†
Sir Peter Middleton (Chair)	United Utilities	c
	Bass	e
Matthew Barrett (Chief Executive)	-	
T D G Arculus‡	Severn Trent	c
	IPC Group	e
Hilary Cropper‡	FI Group	e
P J Jarvis‡	Debenhams	e
	Rank Group	e
Sir Brian Jenkins‡	‘several companies’	e
Sir Andrew Large‡	‘several companies’	e
C J Lendrum	-	
Sir Nigel Mobbs‡	Slough Estates, Bovis Homes Group	e
	Howard de Walden Estates	e
Sir Nigel Rudd‡	Boots Co	b
	Kidde	e
	Pilkington	e
	Pendragon	e
S G Russell‡	-	
J M Stewart	-	
J S Varley	-	
G M Wallace‡	-	

a — transport/vehicles/electronics/communications/defence

b — chemicals/pharmaceuticals

c — oil/energy/utilities

d — finance

e — other

† — companies are classified according to the dominant activity

‡ — non-executive director

Source:Barclays Annual report

The Co-operative Group

The Co-operative Group, owner of the successful and innovative Co-operative Bank, has a very different concept of a board of directors, who are elected by members and have careers which are, by and large, representative of the population at large. The board in 2000 included housewives, a chartered engineer, a teacher, and a manager for Oxfam. The directors are not paid huge fees. In fact, 41 of them received less than £5,000 apiece. The Chief Executive received a total of £431,000, which is substantial, but considerably lower than the amounts paid to chief executives of quoted companies of comparable size. The co-operative movement has had its difficulties in past years — a low profile in a world dominated by brands, and a tendency to follow some way behind consumer tastes — but is now a more dynamic and purposeful organisation, which attracts executives and directors with social as well as financial objectives.

Lloyds TSB

At Lloyds TSB, the majority of the board consists of executive directors, and the non-executives are currently more prominent in the service of higher education than in business. Ewan Brown is Chair of the Court of Heriot-Watt University, Sheila Forbes, Chair of the Governors of Thames Valley University, Thomas McKillop is Pro-Chancellor of Leicester University, and the Earl of Selborne is Chancellor of Southampton University. Table 12 shows that Lloyds TSB board members hold relatively few directorships of major companies.

The executive directors are mostly long-standing staff of the companies in the Lloyds TSB group. Peter Ellwood joined the TSB in 1989, and Michael Fairey joined in 1991. Archie Kane is another TSB man, having started in 1986. Michael Ross has spent his career with Scottish Widows, starting in 1964. M Kent Atkinson joined Bank of London and South America in 1964, and stayed on when the bank became a Lloyds subsidiary in 1971. Dennis Holt has been with Lloyds since 1970. David Pritchard came to TSB in 1995 from Royal Bank of Canada.

The directorships relate mainly to British companies, and thus do not position Lloyds TSB centrally in the web of global business. The length of time which many of the directors have spent with the group's companies gives them deep knowledge of operations, but perhaps there is a need now for a more dynamic vision than the current objective of maximising value to shareholders.

Table 12: Major Directorships Held by Board Members of Lloyds TSB, 2000

	Directorship	Classification†
Maarten van den Bergh (Chair)	British Telecommunications	a
	Royal Dutch Petroleum	c
Alan Moore (Deputy Chair)	-	
Peter Ellwood (Chief Executive)		
Michael Fairey (Deputy Chief Executive)	-	
Michael Ross (Deputy Chief Executive)	-	
M Kent Atkinson	Coca Cola HBC	e
Dennis Holt	-	
Archie Kane	-	
David Pritchard	-	
Ewan Brown‡	Stagecoach Holdings	a
	Noble Grossart	d
	Dunedin Income Growth Investment Trust	d
A Clive Butler‡	Unilever	e
Sheila Forbes‡	-	
Chritopher S Gibson-Smith‡	BP Amoco	c
Thomas McKillop‡	AstraZeneca	b
Earl of Selbourne‡	The Blackmoor Estate	e
Lawrence Urquhart‡	-	

a — transport/vehicles/electronics/communications/defence

b — chemicals/pharmaceuticals

c — oil/energy/utilities

d — finance

e —other

† — companies are classified according to the dominant activity

‡ — non-executive director

Source:Lloyds TSB Annual report

Abbey National

The Abbey National board has as much financial expertise as Lloyds TSB's board. The other directorships held by the non-executives tend to be of slightly smaller companies than those of the Lloyds TSB directors. Abbey National's non-executives have extensive knowledge of the UK's cultural life. For example, Sir Terence Heiser is on the executive committee of the National Trust, Keith Woodley is a director of Learning Through Landscapes, and Lord Shuttleworth is a former Chair of the Rural Development Commission.

Table 13: Major Directorships Held by Board Members of Abbey National, 2000

	Directorship	**Classification†**
Lord Tugendhat (Chair)	Eurotunnel	a
	Blue Circle Industries	e
	Rio Tinto	e
Ian Harley (Chief Executive)	Rentokil Initial	b
	Dah Sing Financial Holdings	d
Malcolm Millington	-	
Timothy Ingram	-	
John King	-	
Gareth Jones	Somerfield	e
Andrew Pople	-	
Mark Pain	-	
Yasmin Jetha	-	
Ian Tracey	-	
Keith Woodley (Deputy Chair)‡	-	
Leon Allen‡	Braes Group	e
Mair Barnes‡	Scottish Power	c
	Woolworths Holdings (South Africa)	e
Richard Hayden‡	GSC Partners Europe	d
Peter Ogden‡	Computasoft	e
	Computacenter	e
	Psion	e
	Omnia	e
Sir Terence Heiser‡	-	
Lord Currie‡	-	
Lord Shuttleworth‡	-	

Table continued overleaf...

Table 13: Major Directorships Held by Board Members of Abbey National, 2000

...table continued from previous page

a — transport/ vehicles/electronics/communications/defence

b — chemicals/pharmaceuticals

c — oil/ energy/utilities

d — finance

e — other

† — companies are classified according to the dominant activity

‡ — non-executive director

Source:Abbey National Annual report

HBOS

The board of the new HBOS should be: Dennis Stevenson, Executive Chair; Peter Burt, Executive Deputy Chair; and James Crosby, Chief Executive. Interesting appointments of non-executive directors include 36 year-old entrepreneur Charles Dunstone, Chairman and CEO of the Carphone Warehouse; Tony Hobson (53), formerly Finance Director at the dynamic insurer Legal & General; and Lord Simpson of Dunkeld (58), who was forced to quit as Chief Executive of the suffering defence and electronics company Marconi on 5th September 2001. Sir Bob Reid (67) is also a Non-Executive Director of the Sun Life Assurance Co of Canada, among numerous other directorships. The range of expertise across the new board encompasses shipping, defence, electronics, transport, finance, utilities, property, building, management consultancy, media communications, and leisure — for example, Philip Yea (46) is a Director of Manchester United. The composition of the board suggests that the new bank will seek to expand its role in business banking and in long-term insurance. The acquisition of assets from Equitable Life was already a pointer in this direction.

Legal & General

The board of Legal & General is out of the ordinary in that, at the end of 2000, four of the 16 directors were women, who are certainly not token but have distinguished heavyweight careers of their own. They were Kate Avery, an Executive Director who was previously the Managing Director of Barclays Stockbrokers; and three non-executives — Beverley Hodson, Managing Director of WH Smith Group; Elizabeth Wall, Senior Vice-President, General Counsel and Company Secretary at Equant NV; and Honor Chapman CBE, International Director of Jones Lang LaSalle. There is also a Lord on the board; Lord Burns has a great wealth of knowledge of government from his time as Chief Economic Adviser and Permanent Secretary to HM Treasury.

Alliance & Leicester

At Alliance & Leicester, the board has greater international experience than at some of the larger banks. The Executive Chair John Windeler came from National Australia Bank, Michael Allen was in charge of European Operations for Procter & Gamble, David Bennett was an Executive Director of National Bank of New Zealand, the Hon David Brougham has interests in the Asia Pacific region, and Mike McTighe in the US. The board's overseas experience could be very useful in any future strategy to diversify beyond the UK.

7. Promotion and Advertising

OVERVIEW

The Double-Edged Effect

Powerful brand names are a double-edged sword. When the products are sound and there are no regulatory scandals, the big brand wins. When products are poor quality, or customers are misled, or a company has made unwise commercial decisions, the brand name suffers, as does everything associated with it. This happened to Equitable Life, because of its inability to fund guaranteed annuities — the start of an ongoing disaster.

Sport-Linked Ventures

Manchester United, one of the world's leading brands, is now being applied to financial services: insurances, and more savings accounts, to build on the base of a credit card and a savings account, which are popular with fans. The Virgin brand in financial services, controlled by Sir Richard Branson and AMP of Australia, is to be extended to Europe, and then probably to Japan and other parts of South East Asia.

From football extending into financial services, to financial services promoting football: the UK's largest surviving building society, the Nationwide, sponsors the English Football League, and renewed its sponsorship in 2001 with £12m for 3 years. Nationwide also sponsors football in Wales and Scotland, for £10m a year. The Halifax intends to draw new customers to its new Rugby Round-up credit card, issued through rugby clubs to members and supporters. Clubs receive £10 for each new customer, and 0.02% commission on each £100 spent. Football is not, however, to everyone's taste — AXA is rumoured to be in two minds over whether to continue sponsoring the FA Cup after 2002.

Royal Bank of Scotland sponsors golf through the Ryder Cup and the European tour. The bank chose golf because it seeks to expand the number of business customers, among whom golf is a popular activity.

These sport-linked ventures are targeted primarily at men, and are predicated on the assumption that sporting loyalty will extend to financial loyalty, encouraged by cross-branding. There is the risk that consumers will tire of a branded world, but there are few signs of this yet.

Mergers and Acquisitions

Mergers and acquisitions create branding problems. HBOS (Halifax Bank of Scotland) is very similar to HSBC (Hong Kong & Shanghai Banking Corporation). Royal & Sun Alliance is too much of a mouthful, as is CGNU. The latter has opted to use the respected Norwich Union brand in the UK. Barclays has so far retained the Woolwich brand, and Royal Bank of Scotland has kept National Westminster. The use of multiple brands gives the public an illusion of choice, because only those who closely follow the financial news can really appreciate who owns whom.

Brand development is becoming a big headache because of fragmentation of promotion channels, audiences and messages. The over-65s tend to watch whole TV programmes, often in daytime, but younger viewers zap between channels, often in order to miss advertisements. The straightforward advertisement has lost its impact, and now brand development needs to be integrated across many channels, so as to build and reinforce the message.

Marks and Spencer's Indecision

Marks and Spencer, which has still not decided whether it is primarily a retailer or a financial services company, has decided to stage a major campaign for stakeholder pensions, although margins on these pensions are very slim. The Marks and Spencer campaign is targeted at women, who might not know that they can take out stakeholder pensions of behalf of others, now that contributions, up to certain levels, do not depend on their own income. Marks and Spencer has also launched a campaign for home and contents insurance cover, on direct response TV, radio and in national newspapers including *The Times* and the *Daily Express*.

Friends Provident's demutualisation campaign was cleverly orchestrated, using posters, online adverts and news articles among other channels. The campaign was formulated for a specific event — demutualisation — and a specific product — discounted shares. Advertising is becoming more closely linked to product innovations, while public relations and sponsorship build general brand identities by associating brand names with particular qualities, such as the Nationwide with England's national game of football, and Bank of Scotland with the Edinburgh International Festival.

ADVERTISING EXPENDITURE

Spending Increases

Companies' response to the fragmentation of advertising channels is to spend more: almost £1bn in the UK, year to end June — 13.1% more than in the preceding year. Table 14 shows main media advertising expenditure.

Table 14: Main Media Advertising Expenditure in the Principal Categories of Financial Services (£000 and %), 1999/2000 and 2000/2001

	1999/2000 (£000)	2000/2001 (£000)	% Change 1999/2000-2000/2001
Corporate	68,475	71,226	4.0
Credit cards	59,322	60,492	2.0
Banking services, general	15,513	44,597	187.5
Motor insurance	24,831	40,174	61.8
General investment schemes	27,861	38,659	38.8
Personal loans, unsecured	24,630	35,173	42.8
Accountants and solicitors	21,159	32,901	55.5
Unit trust ISAs	8,196	27,659	237.5
Personal loans, secured	4,984	26,791	437.5
Online banking	29,005	22,317	-23.1
Mortgages, general	30,983	19,306	-37.7
Private medical insurance	17,734	19,008	7.2
Financial announcements	15,213	18,558	22.0
Flexible mortgages	7,756	17,511	125.8
Private banking	12,471	17,461	40.0
Integrated banking	*n.a.*	16,762	*†*
Independent financial advice	22,326	16,635	-25.5
Insurance, general	24,669	16,225	-34.2
Online current/HICA accounts	3,092	14,729	376.4
Life assurance	18,069	12,332	-31.8
Domestic contents insurance	9,329	11,136	19.4
Mortgage and related products	10,810	10,490	-3.0
Term assurance	15,618	10,314	-34.0
Online plastic cards	8,891	10,169	14.4
Personal loans, general	27,957	10,041	-64.1
Total (including categories below £10m for 2000/2001)	**806,698**	**912,436**	**13.1**

Table continued overleaf...

Table 14: Main Media Advertising Expenditure in the Principal Categories of Financial Services (£000 and %), 1999/2000 and 2000/2001

...table continued from previous page

Base: all categories with expenditure exceeding £10m in 2000/2001

HICA — high-interest cheque account

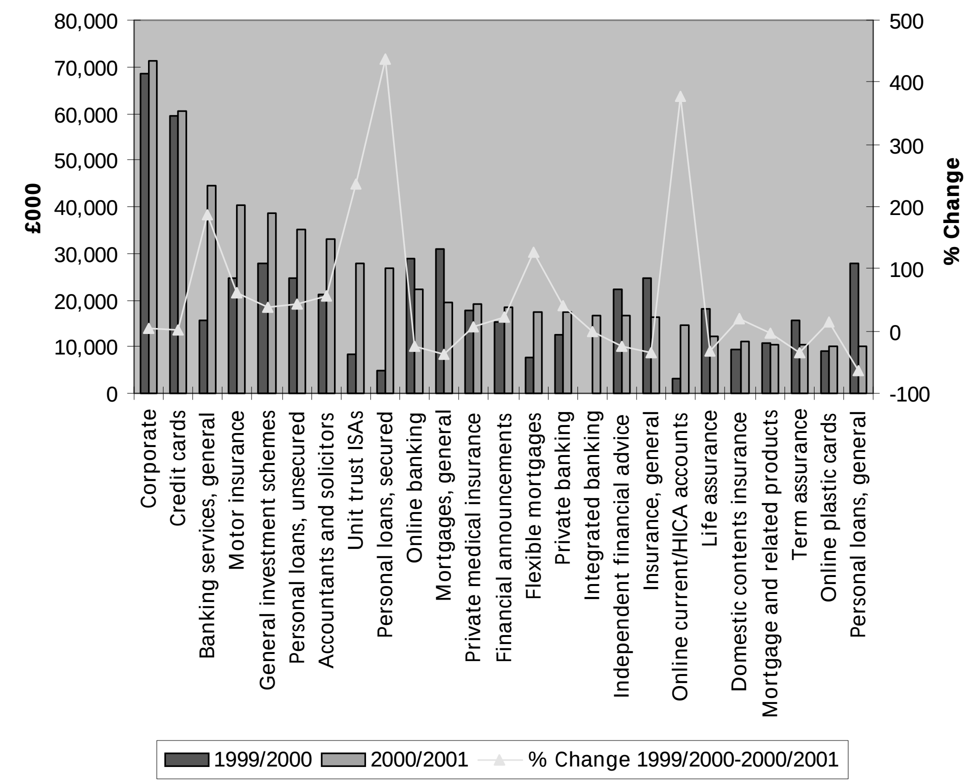
n.a. — not available

† — calculation not possible

Note: years to end June

Source:ACNielsen MMS

Figure 7: Main Media Advertising Expenditure in the Principal Categories of Financial Services (£000 and %), 1999/2000 and 2000/2001



Base: all categories with expenditure exceeding £10m in 2000/2001

HICA — high-interest cheque account

Note: years to end June

Source:ACNielsen MMS/Key Note

A Year Makes a Big Difference

Secure personal loans, online current accounts and unit trust ISAs were all advertised far more extensively in 2000/2001 than in 1999/2000. Advertising of personal loans has become more specific, so general loan advertising has slumped. The same applies to mortgages. Flexible mortgages are the new fashionable product. The emphasis is on promoting the benefits of specific products, rather than mortgage or loan ranges in general. The picture is one of steady spending on corporate advertising to build brand awareness, and then concentrating on individual products to niche markets. Table 14 and Figure 7 show the expenditure categories of over £10m in the years to 30th June 2000 and 2001. In 2001, they are headed by corporate advertising (7.8% of the total), credit cards (6.6%), and general banking services (4.9%). The previous year, the top three were corporate advertising (8.5%), credit cards (7.4%) and general mortgages (3.8%).

It is unwise to draw precise conclusions from the ACNielsen MMS data, because not all media are included in the monitoring — with the growth of highly specialised media publications and channels, this would be impossible. The sums spent are calculated at rate-card values, which may often not apply. Products are placed somewhat arbitrarily into categories. The categories ‘mortgages — general’, and ‘mortgages and related products’ have very fuzzy edges. New categories are created, such as ‘integrated banking’, which includes all-in-one accounts such as Virgin One. This category overlaps with ‘flexible mortgages’, which also includes the Virgin One account with the same buying agency listed (Manning Gottlieb Media) but a different expenditure. Media expenditure figures are a guide to what is happening in the advertising market, but are a general rather than a specific guide. Their utility is declining as products and distribution channels multiply.

Bearing this caution in mind, an analysis of the leading advertisers in the major categories in 2000/2001 has some surprises.

Corporate Finance

Lloyds TSB was the leading corporate advertiser in the year to 30th June 2001, according to ACNielsen MMS. This reflects the high-profile but thwarted campaign to take over Abbey National. Abbey National, keen to stay independent, has spent £5.5m on raising its brand profile. Close behind at £5.4m, Standard Life remains keen to raise its brand reputation to help it withstand pressures to float, after surviving one campaign by members keen to acquire windfalls. The leading UK insurer in the corporate spending league was Norwich Union, the chosen branding for CGNU, just ahead of Royal Liver. The top 11 accounted for 62.6% of total spending in the category.

Table 15: Major Advertisers of Corporate Finance (£000 and %), Year to June 2001

	£000	% of Category
Lloyds TSB	9,009	12.6
Abbey National	5,485	7.7
Standard Life	5,403	7.6
Norwich Union	5,373	7.5
Royal Liver	3,599	5.1
UBS	3,360	4.7
Credit Suisse First Boston	2,789	3.9
Deutsche Bank	2,461	3.5
Accenture†	2,415	3.4
Friends Provident	2,386	3.3
Zurich Financial Services	2,321	3.3

Table continued overleaf.....

Table 15: Major Advertisers of Corporate Finance (£000 and %), Year to June 2001

...table continued from previous page

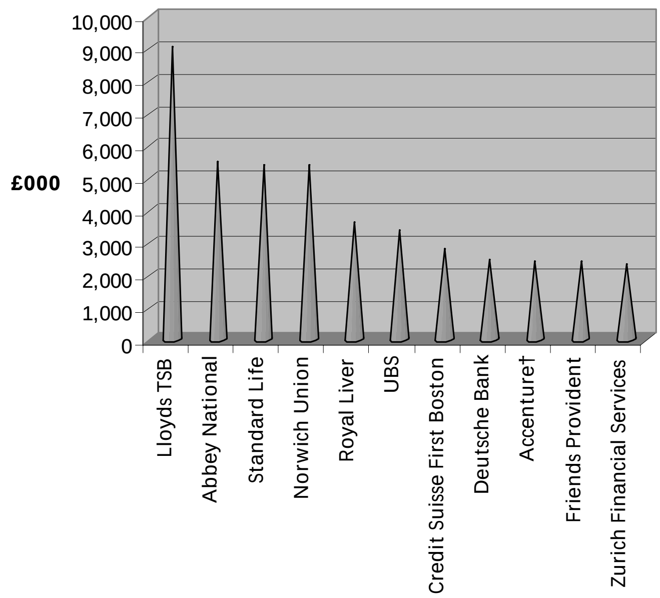
	£000	% of Category
Total for top 11	**44,601**	**62.6**
Total for category	*71,226*	*100.0*

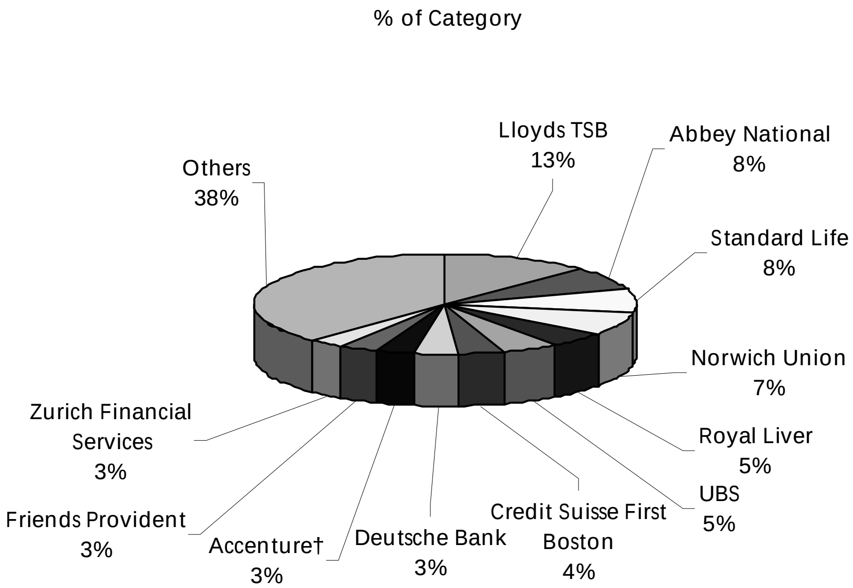
† — ACNielsen MMS has classified Accenture as a financial organisation, but it is a company providing management and technology consulting services to sectors including finance

Base: all companies spending over £2m

Source:ACNielsen MMS

Figure 8: Major Advertisers of Corporate Finance (£000 and %), Year to June 2001





† — ACNielsen MMS has classified Accenture as a financial organisation, but it is a company providing management and technology consulting services to sectors including finance

Base: all companies spending over £2m

Source:ACNielsen MMS/Key Note

Credit Cards

In the major credit-card category, the top eight companies have 88.5% of the spend — and Barclaycard alone has 24.2%. The former building societies Halifax and Alliance & Leicester are extremely keen to expand their credit-card customer base. There are four US and four UK companies in the top eight advertisers — credit remains an Anglo-American speciality.

Barclaycard now has a new 'softer icon' to reflect its 'less austere, more consumer-friendly approach', according to Andy Black, Managing Director of Springetts, the company that masterminded the redesign.[1] The redesign appears to be a response to the quirky images of credit cards like Goldfish and Egg.

Halifax's wish to expand in credit cards is reflected in its June 2000 purchase of the UK card business of American company Bank One, as part of its strategy to increase its card business by 50% in 3 years, from 2 million to 3 million customers. In April 2000, Halifax Card Services gained a Marketing Director for the first time, when Martin Johnson was recruited from Citibank.[2]

Table 16: Major Advertisers of Credit Cards (£000 and %), Year to June 2001

	£000	**% of Category**
Barclaycard	14,643	24.2
American Express	11,414	18.9
Mastercard	7,490	12.4
Morgan Stanley Dean Witter	5,305	8.8
Alliance & Leicester	4,742	7.8
Halifax	4,584	7.6
Royal Bank of Scotland	3,085	5.1
MBNA	2,301	3.8
Total for top eight	**53,564**	**†88.5**
Total for category	*60,492*	*100.0*

Base: all companies spending over £2m

† — does not sum due to rounding

Source:ACNielsen MMS

1. See 'All credit to Springetts for Barclaycard identity' by Hannah Booth, MAD, 29th March 2001.
2. 'Halifax Cards appoints first marketing director', MAD, 29th March 2001.

General Banking Services

This category is really a repository for advertisements which are the hardest to classify, and which ACNielsen MMS has decided are not 'corporate'. The Royal Bank of Scotland's NatWest headed this grouping, with an enormous expenditure estimated at £19.7m. HSBC, which tends to keep its product-specific advertising rather low key, spent £6.1m. The Nationwide also features prominently, with £3.5m, promoting the virtues of mutuality.

Table 17: Major Advertisers of General Banking Services (£000 and %), Year to June 2001

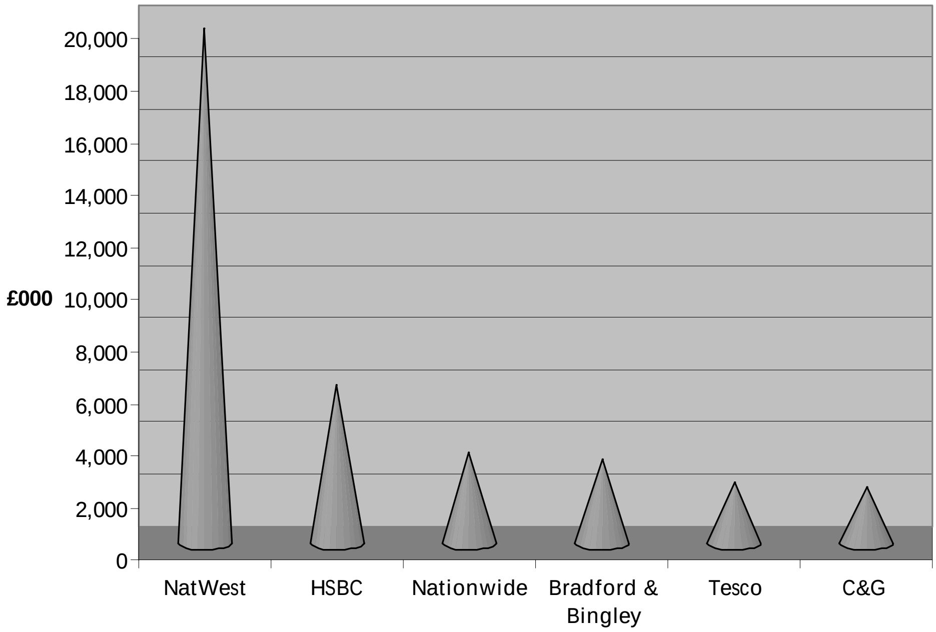
	£000	% of Category
NatWest	19,749	44.3
HSBC	6,107	13.7
Nationwide	3,480	7.8
Bradford & Bingley	3,235	7.3
Tesco	2,345	5.3
Cheltenham & Gloucester	2,167	4.9
Total for top six	**37,083**	**†83.2**
Total for category	*44,597*	*100.0*

Base: all companies spending over £2m

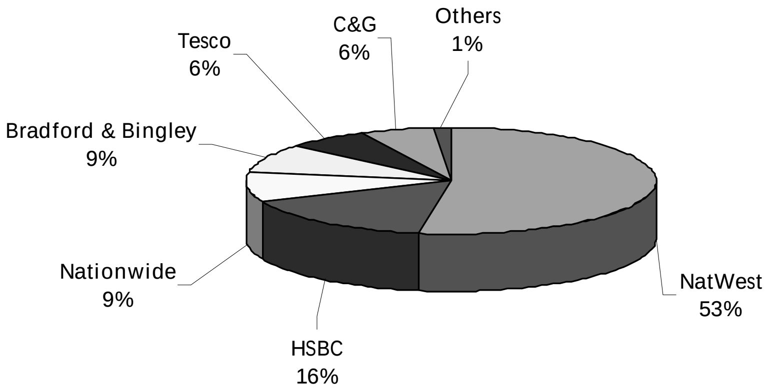
† — does not sum due to rounding

Source:ACNielsen MMS

Figure 9: Major Advertisers of General Banking Services (£000 and %), Year to June 2001



% of Category



Base: all companies spending over £2m

Source:ACNielsen MMS/Key Note

Motor Insurance

According to ACNielsen MMS, the AA, now part of the energy company Centrica, was the largest advertiser of motor insurance, spending £9.5m, and was followed by Direct Line, at £7.9m. Both the AA and Saga are distributors, using their customer bases as the nucleus for direct marketing. Churchill was thought up by Martin Long of the UK, but is funded by the Swiss long-term insurance company Winterthur, and achieves high renewal rates of over 80% from its million-plus customers, compared with an industry average of less than 60%.

Table 18: Major Advertisers of Motor Insurance (£000 and %), Year to June 2001

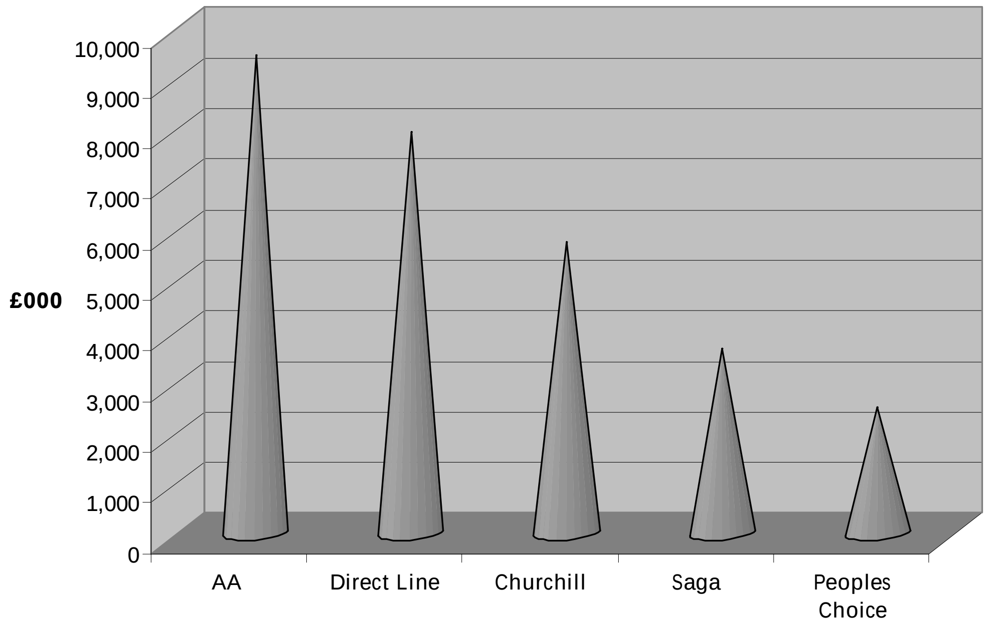
	£000	% of Category
AA	9,461	23.5
Direct Line	7,935	19.8
Churchill	5,757	14.3
Saga	3,658	9.1
Peoples Choice	2,503	6.2
Total for top five	**29,314**	**†73.0**
Total for category	*40,174*	*100.0*

Base: all companies spending over £2m

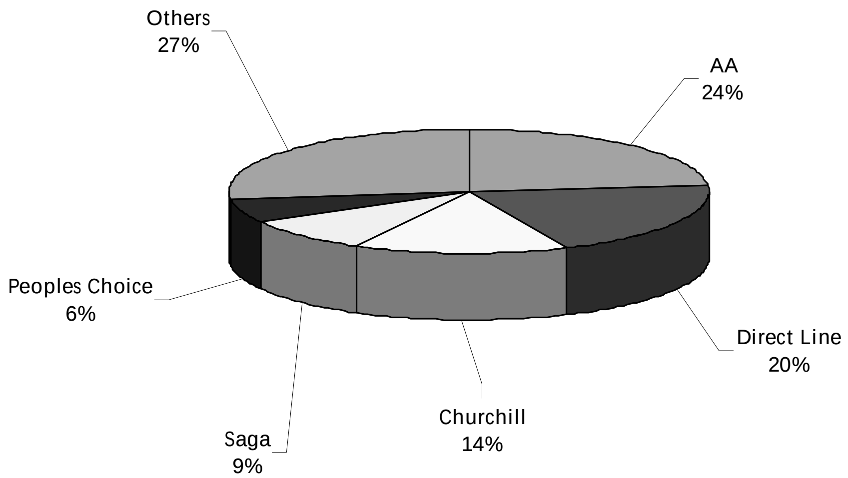
† — does not sum due to rounding

Source:ACNielsen MMS

Figure 10: Major Advertisers of Motor Insurance (£000 and %), Year to June 2001



% of Category



Base: all companies spending over £2m

Source:ACNielsen MMS/Key Note

General Investment Schemes

ACNielsen MMS's 'general investment schemes' category is headed by Norwich Union, the CGNU brand, spending £8.3m on its investment products, followed by Clerical Medical — part of the Halifax — with £5.5m. These two account for 35.7% of the total spend.

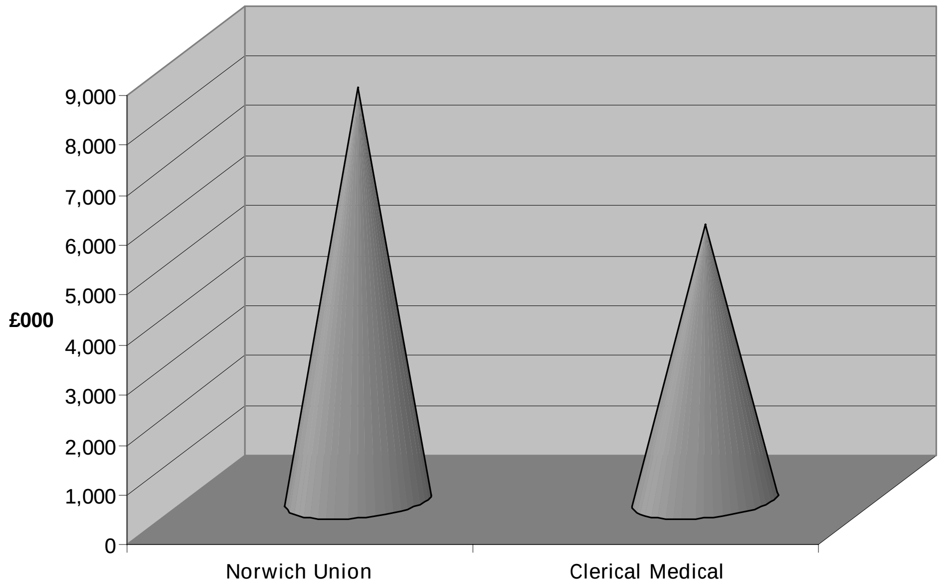
Table 19: Major Advertisers of General Investment Scheme (£000 and %), Year to June 2001

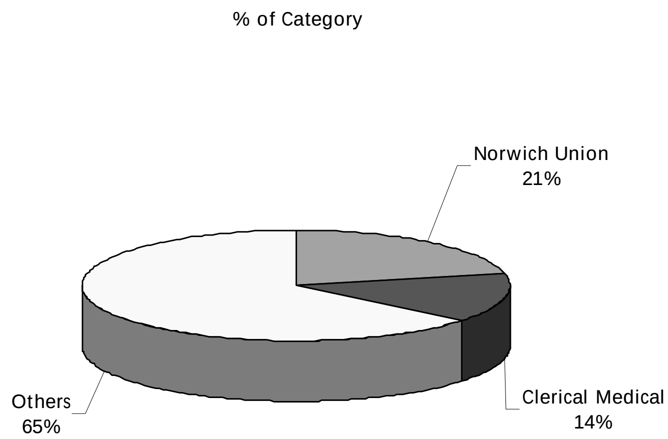
	£000	% of Category
Norwich Union	8,265	21.4
Clerical Medical	5,527	14.3
Total for top two	**13,792**	**35.7**
Total for category	*38,659*	*100.0*

Base: all companies spending over £2m

Source:ACNielsen MMS

Figure 11: Major Advertisers of General Investment Scheme (£000 and %), Year to June 2001





Base: all companies spending over £2m

Source:ACNielsen MMS/Key Note

Unsecured Personal Loans

Royal Bank of Scotland dominates advertising in this category, through its Lombard Bank/Direct (acquired with NatWest) and Direct Line businesses. Together they accounted for 44.8% of all advertising in the category.

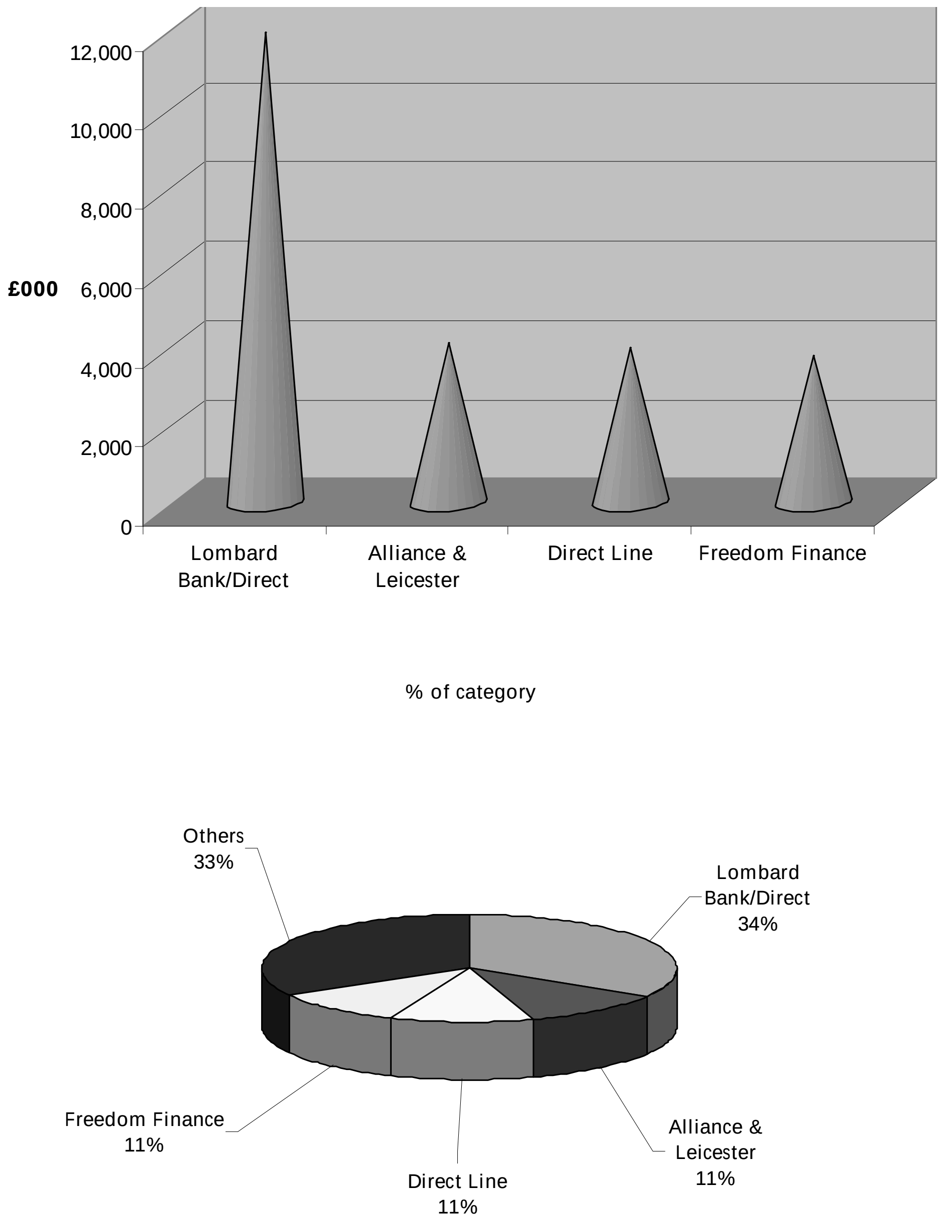
Table 20: Major Advertisers of Unsecured Personal Loans (£000 and %), Year to June 2001

	£000	% of Category
Lombard Bank/Direct	11,861	33.7
Alliance & Leicester	4,017	11.4
Direct Line	3,910	11.1
Freedom Finance	3,722	10.6
Total for top four	**23,510**	**66.8**
Total for category	*35,173*	*100.0*

Base: all companies spending over £2m

Source:ACNielsen MMS

Figure 12: Major Advertisers of Unsecured Personal Loans (£000 and %), Year to June 2001



Base: all companies spending over £2m

Source:ACNielsen MMS/Key Note

Accountants and Solicitors

This used to be a minor advertising category, until the arrival of Claims Direct, which alone accounted for 68.9% of the spend of the whole category. Claims Direct encourages people to claim against insurance companies, and is thus a very mixed blessing for the insurers. During the early months of 2001, signs emerged that Claims Direct's massive advertising spend was failing to bring in commensurate amounts of new business. This was bad news for the Abbey National subsidiary First National, which provided £100m of funding.

In March 2001, Claims Direct announced that it expected an operating loss for the second half of its financial year, compared with a profit of £11.8m for the first 6 months. A few days later, Marketing Director Roger Plantier left the company. The company was in the news again in July 2001, when the founder, Tony Sullman, and co-founder Richard Poole, launched a £19.4m buy-back — after receiving £50m between them when the company floated in July 2000. Messrs Sullman and Poole want to remodel the company because the number of claims it is pursuing has fallen from around 5,000 a month to fewer than 2,000. The share value also dived from 353 pence to 13.3 pence on 11th July 2001. This was not very good news for the legal firms who have bought into Claims Direct as franchisees. Further gloom descended in late July, when the Department of Trade and Industry (DTI) announced an investigation into the company. In August, the founders agreed to sell their majority holding, and control of the company to Simon Ware-Lane.

Table 21: Major Advertisers of Accountants and Solicitors (£000 and %), Year to June 2001

	£000	**% of Category**
Claims Direct	22,669	68.9
Total for category	**32,901**	**100.0**

Base: all companies spending over £2m

Source:ACNielsen MMS

Unit Trust ISAs

Lloyds TSB's Scottish Widows led the unit trust ISA advertising, but is proving fairly slow to develop products which spread investors' risk when markets are falling. The American investment specialists Fidelity are more proactive. The insurer Norwich Union aims to be a major force in ISAs, but 2001 is hardly the best time to be in this market. Jupiter International Group, spending £3.7m on advertising unit trust ISAs in the year to end June, is a subsidiary of Commerzbank of Germany, and Fidelity is ultimately American — so Germany and the US are represented in the top four advertisers of unit trust ISAs.

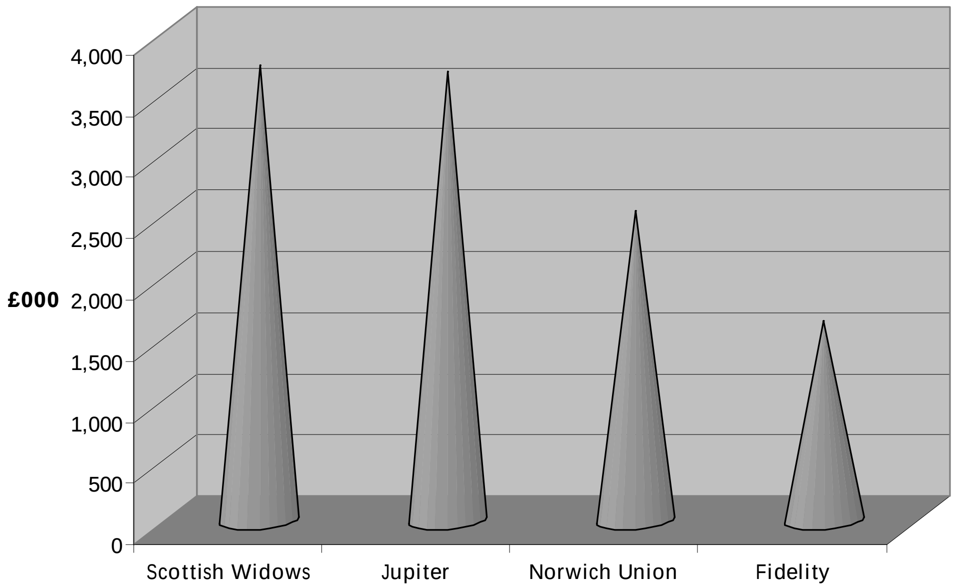
Table 22: Major Advertisers of Unit Trust ISAs (£000 and %), Year to June 2001

	£000	% of Category
Scottish Widows	3,716	13.4
Jupiter	3,672	13.3
Norwich Union	2,535	9.2
Fidelity	1,630	5.9
Total for top four	**11,553**	**41.8**
Total for category	*27,659*	*100.0*

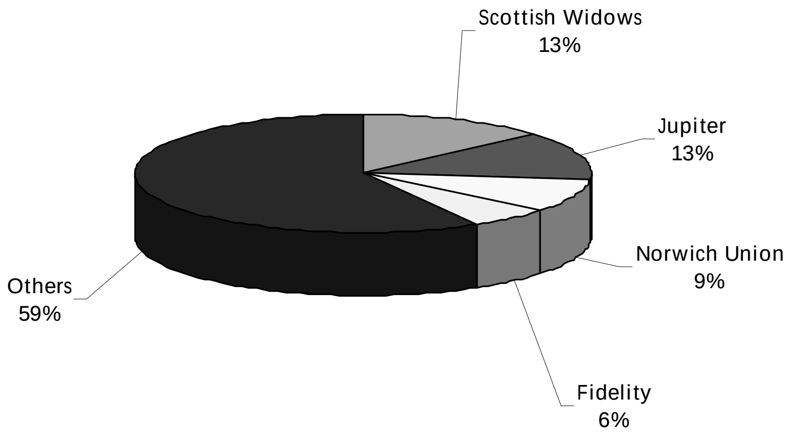
Base: all companies spending over £2m

Source:ACNielsen MMS

Figure 13: Major Advertisers of Unit Trust ISAs (£000 and %), Year to June 2001



% of Category



Base: all companies spending over £2m

Source:ACNielsen MMS/Key Note

Online Banking

In this category, Abbey National and its e-bank Cahoot spent 44.4% of the category total and Barclays spent 22.9%. The top five accounted for 92% of the total.

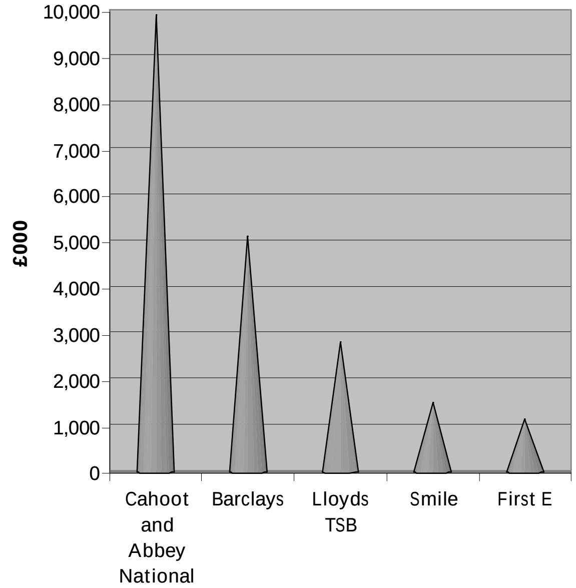
Table 23: Major Advertisers of Online Banking (£000 and %), Year to June 2001

	£000	% of Category
Cahoot and Abbey National	9,917	44.4
Barclays	5,107	22.9
Lloyds TSB	2,830	12.7
Smile	1,513	6.8
First E	1,154	5.2
Total for top five	**20,521**	**92.0**
Total for category	*22,317*	*100.0*

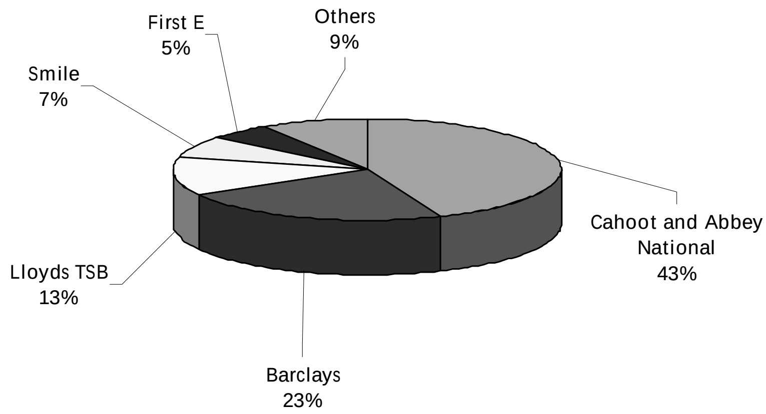
Base: all companies spending over £2m

Source:ACNielsen MMS

Figure 14: Major Advertisers of Online Banking (£000 and %), Year to June 2001



% of Category



Base: all companies spending over £2m

Source:ACNielsen MMS/Key Note

General Mortgages

The Halifax, Britain's biggest lender, led the general mortgages category narrowly from Bradford & Bingley's John Charcol mortgage-broking service. HSBC, which has been increasing its involvement with loans for home purchase, was also strongly promoted.

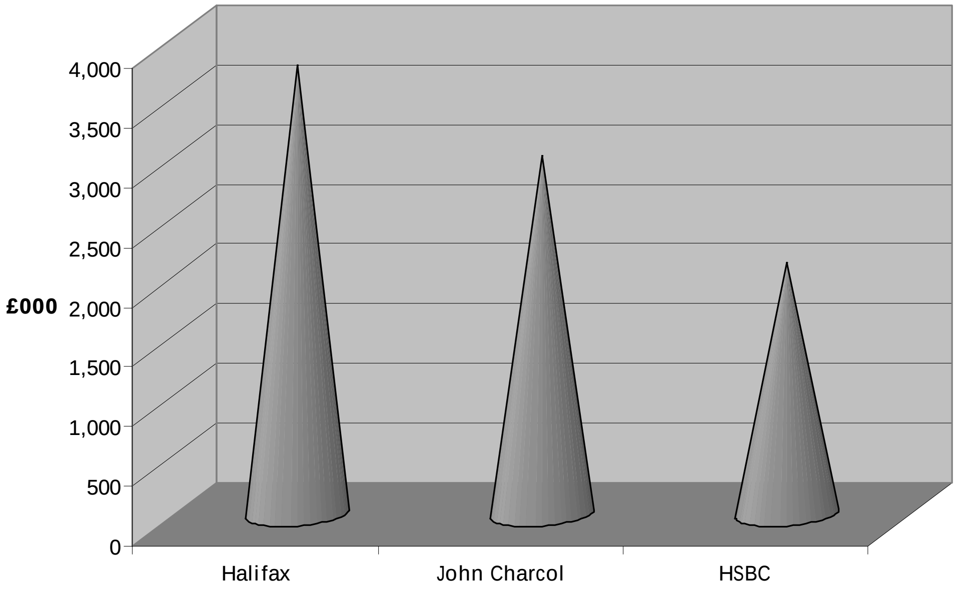
Table 24: Major Advertisers of General Mortgages (£000 and %), Year to June 2001

	£000	**% of Category**
Halifax	3,770	19.5
John Charcol	3,008	15.6
HSBC	2,104	10.9
Total for top three	**8,882**	**46.0**
Total for category	*19,306*	*100.0*

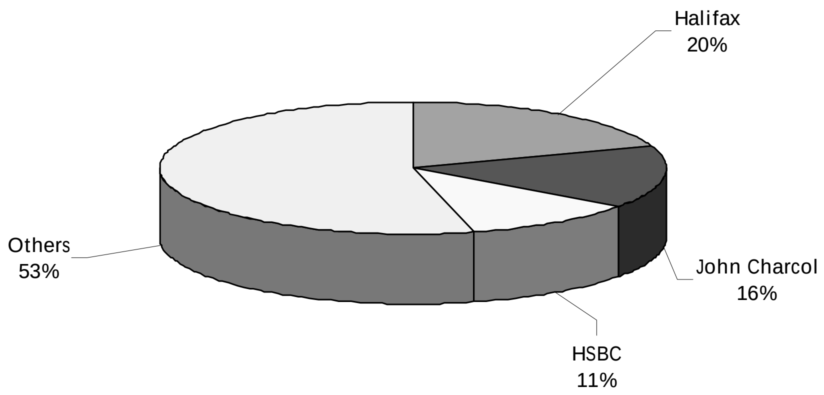
Base: all companies spending over £2m

Source:ACNielsen MMS

Figure 15: Major Advertisers of General Mortgages (£000 and %), Year to June 2001



% of Category



Base: all companies spending over £2m

Source:ACNielsen MMS/Key Note

DIRECT MARKETING

Direct mail, used extensively by financial services companies, depends on lists — of customers, society members, people who have completed 'opinion' questionnaires in the hope of winning a draw prize, and the list of electors: the electoral roll. The electoral roll is a public document but the Government is not happy about its use for marketing, and proposed to ban it from 2001, costing the direct marketing industry around £250m annually. The ban has been postponed until 2002, to give companies time to compile lists from other sources but another postponement is unlikely.[1]

Direct marketing, embracing direct mail, phone calls, faxes and e-mails, will have to assume greater importance than ever before because blanket advertising for niche products is too expensive. Britannic Retirement Solutions is planning such a campaign, for annuities. The list is being derived from responses to press advertisements, in the major Sunday papers and the Reader's Digest. Britannic is creating a special website to appeal to 'silver surfers', and is assembling a direct salesforce to specialise in selling annuities. The ageing population means that the annuity market is bound to become more and more significant in the years to 2050.

1. 'DM industry gets access to electoral roll for another year', by Andrew Wallace, MAD, 9th July 2001.

8. An International Perspective

INTRODUCTION

Overseas companies have been fast to home in on growth sectors in UK financial services, notably equity release and rolling credit. GE Life, a subsidiary of General Electric of the US, and Australian company NPI, have both focused on equity-release products for the expanding numbers of elderly people.

AUSTRALIA

AMP has an expanding presence in the UK, including NPI, Pearl Assurance and Henderson Investors. In June 2000, the group’s interests in the UK, which include 50% of Virgin Direct, expanded with the launch of AMP Bank — initially, at least, intended only for Pearl customers. Pearl’s staff distribute AMP Bank products alongside life assurance and pensions products. In July 2001, AMP took over the ailing online trading company Interactive Investor International (iii) for £52.1m, with the intention of merging it with its online funds supermarket Ample. Interactive Investor International has 1.2 million accounts, which are the attraction for AMP. The joint venture with Virgin is likely to be expanded into Europe and South East Asia, including Japan.

AMP itself lost money in 1999 but made a £200m profit in the first half of 2000, and manages global assets of more than £105bn.

National Australia Bank is one of the five largest companies listed on the Australian Stock Exchange, and has the ambitious objective of becoming the world’s leading financial services company. At present, 51% of its assets are outside Australia, including Clydesdale Bank and Yorkshire Bank in the UK, and it has 12 million customers.

Like AMP, National Australia Bank has special expertise in financial products for the over-50s, for example, remortgages. Between 1996 and 2000, home loans to Australians over 50 years-old rose by 54%, five times more than the overall growth rate for loans. In Australia, ‘gearing has become an active part of (older customers’) wealth creation strategies to boost savings’, said Ken Hodgson, the bank’s General Manager for Personal Financial Services. National Australia Bank achieved record operating profits in 2000, A$3.38bn, almost 20% more than in the previous year.

Both AMP and National Australia Bank see great opportunities for specialised financial services for the elderly in the UK, with its ageing population.

FRANCE

AXA's purchase of Sun Life and Guardian Royal Exchange has made the French group a significant presence in the UK insurance market. AXA Sun Life has seized on the potential for products geared to the needs of the elderly, such as guaranteed life insurance. Sun Life's direct operation sells a growing range of products such as life insurance (including guaranteed insurance for the over-50s), ISAs and pensions. Sun Life also sells through independent financial advisers (IFAs). Its sister company AXA Assurance sells direct and through tied agents, not through IFAs.

Sun Life, which incorporated AXA Equity & Law in 1997, launched an annuity with a minimum income guarantee in 1999. Investors may be nervous, because of the Equitable Life debacle, but Sun Life feels that the product is simple and reassuring. The aim is to provide more income every year, with the guarantee that the amount paid out will never be less than in the first year.

AXA Group negotiated another sales outlet in the UK, with the Woolwich, although this may change as a result of Barclays' takeover of the Woolwich. The AXA-Woolwich agreement was concluded in August 2000, and enabled the Woolwich to sell AXA insurance products on the Open Plan online service.

AXA spends heavily on sponsorship, for example, the FA Cup. This raises the company's profile among young men who will be important future customers, and counterbalances the current sharp focus on the elderly.

Life and pensions performed well for the company in 1999, earning £246m in operating profits, up by 15%. Operating profits overall rose 29% to £571m. The company plans to distribute £550m in orphan assets to policyholders in 2001. This has sparked a major controversy because the company's total orphan assets are far higher — over £1.76bn. The Consumers' Association thinks that at least 90% of orphan assets should be distributed. However, the FSA has approved AXA's plan, which has a corollary that in return for the hand-out, policyholders must give up all claims to the remainder of the orphan assets. At least 35% of policyholders have to approve the proposal.

Improved relationships with customers, to reduce churn, are a priority. As a start, the Group launched a data-mining programme in summer 2000, with the intention of passing information between the divisions, eventually worldwide.

During 2000, AXA grew substantially, buying out the minority shareholdings in AXA Financial and Sun Life & Provincial Holdings, and acquiring Sanford Bernstein and Nippon Dantai. Acquisitions and sales cost 20bn euros, and the embedded value of the Group rose by 26.6% to 35.35bn euros. The adjusted net asset value fell, however, by 3.9%, because of 'significant goodwill associated with the acquisitions, largely offset by the increase in shareholder equity and the change in unrealized capital gains in businesses other than life'.[1] The embedded value per share rose 7.1% to 20.98 euros. Growth continued in the first quarter of 2001, particularly in international insurance (up 40.5% to 2bn euros). Life and savings rose marginally, by 0.6%, to 12.4bn

1. *'AXA Group reports embedded value for 2000 up 26.6% to Euro 35.35 billion', from AXA, 27th June 2001.*

euros. In the UK, total written premiums grew 14.5% to 2.19bn euros, almost three-quarters the figure for AXA's home French market. Single-premium pensions showed a 50% rise, a result of a taxation change which meant that 2000/2001 was the final year in which investors could carry forward pension contributions.

The company has troubles in its home nation, where Henri de Castries, Chief Executive, and Claude Bébéar, Chair of the Supervisory Board, were placed under formal investigation in relation to alleged tax evasion at Banque Worms and PanEuroLife.

GERMANY

Allianz, Europe's largest insurer, owns Cornhill in the UK, but in recent months has been turning eastwards to look for major acquisitions, for example, the recent 45% stake in the Russian insurer ROSNO, which now includes three Allianz directors on its board. In the Philippines, Allianz is the principal reinsurer for the huge 'city of the future' project — Global City, near Manila, comprising over a thousand acres where 150,000 people will live and work. Allianz has a half share in Mondial Assistance, which, in July 2001, acquired the 'amber light' assistance services company Worldcare Assist, the market leader in Australia. During 2000/2001, the company acquired HIH Insurance in Australia, Zwolsche Algemeene in the Netherlands, and businesses in Eastern Europe including Bulgaria and Romania.

Closer to home, Allianz plans to take over Dresdner Bank for 24bn euros, to give customers access to the whole range of bancassurance services, and to present the new organisation with hoped-for annual synergy benefits exceeding 1bn euros from 2006, and a number five ranking in the worldwide asset management market. Around 20 million German residents are already customers of Allianz or Dresdner, so the merged company will need to look overseas for its main expansion opportunities.

Allianz enjoyed a highly successful year in 2000, with net income of 3.46bn euros, up 49% on 1999 and representing almost 6% of gross written premiums, and 7% of net written premiums. The company employs over 120,000 staff.

In the UK, Cornhill has homed in on the life insurance market for the over-50s, with the Senior Security plan. Rising life expectancy aids insurers in this product sector, because more people pay premiums for more years. The company has also decided to sell specifically to the over-50s in general insurance. Cornhill has a two-pronged approach to distribution, selling through IFAs and Cornhill Direct. Growing emphasis on equity release is quite possible, enabling Cornhill to develop its interest in the over-50s outside its traditional life and general insurance products.

The advertising spend for the Senior Security plan was around £3.3m in the year to end June 2000 and £1.9m in the year to end March 2001, when Cornhill and AXA accounted for 88% of all advertising for over-50s life insurance.

Allianz/Dresdner will be larger than Deutsche Bank, which has around 12 million customers worldwide, and nearly 100,000 staff, half of whom work outside Germany. The direct Bank 24 was launched in 1995 and now handles all personal banking. A separate business, Deutsche Bank Private Banking, caters for 500,000 wealthy people worldwide. Deutsche Bank's most important foreign markets include Italy, Spain, France, Belgium and Poland. In the UK, the bank owns Morgan Grenfell. Net income in 2000 doubled to 6.81bn euros, but the Standard & Poor's rating remained AA and not AAA.

A German bank, Direct Anlage Bank (DAB), has bought the Internet share-trading company Self Trade and is refashioning it as a wealth management bank — the current 'in' sector. Self Trade acquired considerable new business in the final 3 months of 2000, estimated at 41% of all new share-trading accounts in the UK.[1]

THE NETHERLANDS

Aegon, one of the world's 10 largest listed insurance groups, has a substantial UK presence including Scottish Equitable and Guardian Financial Services. The company is now expanding in Eastern Europe, notably in Hungary. Aegon is listed on six stock exchanges, has its headquarters in The Hague, and employs more than 24,000 people. Its extensive interests in the US give it dollar earnings which are extremely useful when the euro is weak.

The supervisory board of 11 includes two women (rather than the one woman typical of UK boards). They are Ms KMH Peijs, a Dutch member of the European Parliament, and Ms T Rembe, a partner in Pillsbury Winthrop of San Francisco. At the end of 2000, the Chair of the Board was M Tabaksblat, retired Chair and CEO (Chief Executive Officer) of Unilever and actual Chair of Reed Elsevier. The board is mainly Dutch but also includes members from the US and the UK. The Dutch members nearly all have extensive experience of international business.

Aegon distributes through IFAs directly, especially online, and through partnerships, for example, with Banamex in Spain, with banks in Italy, Hungary and Spain, with the supermarket retailer Albert Heijn in the Netherlands and with the World Marketing Alliance in the Philippines and the US. In the UK, Aegon intends to be big in stakeholder pensions. The UK experience will help the company design similar products for other European countries, because it believes that governments will have to turn to the private sector to help fund mass pensions.

The group already has useful experience of how to 'internationalise' products, for example, MoneyMaxx. This is a savings and unit-linked insurance plan originally developed in the Netherlands as Spaarbeleg, and now customised to market conditions in Germany, Belgium, Spain, Hungary, Italy and the US.

1. 'Self Trade online share trader to rebrand as DAB Bank', MAD, 5th April 2001.

REPUBLIC OF IRELAND

Bank of Ireland has a major presence in the UK with the former building society Bristol & West. The online bank First Active is also Irish, based in Dublin, but the UK business is now 60% owned by Britannic. In the Republic of Ireland, branches and sales through brokers will be retained, because Irish customers like dealing with real people — echoing the findings of recent NOP surveys in the UK. In June 2001, Irish Life & Permanent revealed that it was talking to Royal Liver, which wishes to buy Irish Life's home-collected credit business. Home-collected credit no longer fits Irish Life & Permanent's business strategy.

SWITZERLAND

The Zurich Group has great significance in the UK market, and so does Winterthur, although the latter keeps a lower profile. Zurich owns Allied Dunbar, Eagle Star and Zurich Life.

Winterthur, which funds Churchill Insurance, is the fifth largest financial services company in Europe, concentrating on insurance. The group merged with Credit Suisse in 1997.

UBS is the world's largest global asset manager, looking after over $1,000bn and employing 70,000 people. The group was created in 1998 on the merger of Swiss Bank Corporation with Union Bank of Switzerland.

US

MBNA Corporation, based in Delaware, promotes itself as the world's largest independent credit-card issuer. It was the eighth largest credit-card advertiser in the UK in the year to end June 2001, and is building commercial relationships with such diverse organisations as the Royal Corps of Engineers and AOL. MBNA became a public company in 1990, and has increased net income every year, in the latest year by 30% to $1.3bn.

GE Life's strategy is to concentrate on the over-50s — supplying annuities, equity-release plans, and investment bonds. The company distributes its financial products through IFAs. It has acquired Stalwart, a pioneer of equity release in the UK. Parent company General Electric was interested in adding the mutual Scottish Life to its UK businesses, but dropped acquisition plans in September 2000.

GE Life is by far the biggest advertiser of equity-release products in the UK, spending £4.7m in the year to end June 2000 and £5.9m in the year to end June 2001 — three times more than NPI in second place in the 12 months to June 2000, and 3.7 times more than in the 12 months to end June 2001. Around 80% of the advertising expenditure is on TV spots likely to be seen by viewers interested in antiques, gardening, travel and similar topics appealing to the middle-aged and active elderly.

Clever strategy has secured GE Life a strong position in equity release, which is set to expand rapidly in the UK as older home-owners realise that property has major drawbacks: it may have to be sold in any case, to pay for long-term care, and, although it can be passed to a spouse free of inheritance tax, it is counted in the tax assessment when assets are passed to the next generation. Coverting capital into income can have substantial benefits for retired home-owners.

A sister operation, GE Capital, is known to be interested in acquiring financial services companies in the UK — possibly the mutual Standard Life. The GE Capital Consumer Finance division has over 12 million UK customers for its credit cards and storecards, which include Debenhams and House of Fraser, and is sharing database data with its partner retailers, to ‘create an understanding of our customers as holders of multiple accounts’, according to Stewart MacPhail, Marketing Director of GE Capital Global Consumer Finance.[1]

1. *‘GE Capital wing overhauls data to steer NPD strategy’, by Glen Mutel, MAD, 20th April 2001.*

9. PEST Analysis

POLITICAL FACTORS

The Government, in the person of Trade and Industry Secretary Patricia Hewitt, stopped Lloyds TSB's £17bn hostile bid for Abbey National dead in its tracks on the grounds that the takeover would be against the public interest.

The decision has far-reaching implications for domestic banks and insurers. During the lifetime of the current administration, the 'public interest' is likely to prevent mergers which concentrate more than around a quarter of any market in the hands of one company.

Lloyds TSB/Abbey National combined would have held 27% of UK current accounts, and ministers decided that this would have restricted competition too much.

The Government's decision means that Lloyds TSB will need to look overseas for major growth, that Barclays in turn is unlikely to bid for Abbey National because the Department of Trade and Industry (DTI) would probably block a deal, and that Abbey National itself may be safe from large domestic predators, at least for the time being.

In a political move towards greater openness, there are to be no more tribunal hearings automatically heard behind closed doors at the Financial Services Authority. Parties to tribunals will be able to request private hearings, but the tribunal will have the power to insist that hearings are open to the public. Information from tribunal hearings should add to the investing public's knowledge base and cut out some wrong decisions.

ECONOMIC FACTORS

Weak growth overall, and a continued decline in manufacturing, are likely in the UK during 2001 and 2002. Rural industry is suffering from the impact of foot and mouth, exports to Europe are costly because the pound has appreciated against the euro, and worldwide falls in share prices make corporate and private investors feel less wealthy.

Less wealth means less demand for most financial services, with the exception of secured and unsecured credit, including equity release. This is an important point for banks and insurers generally, and in particular for those that are homing in on wealth management, including HSBC, Lloyds TSB and Barclays.

The main inflationary pressure on the horizon which could kick the world into recession is the price of oil. Should OPEC (Organisation of the Petroleum Exporting Countries)opt to cut supplies, the outcome would probably be a slump. OPEC is likely to follow this path only by miscalculation, because OPEC's members' investments would be damaged. The July 2001 price of around $24 a barrel is probably just about low enough to prevent a severe slump.

The global downturn is evident in the tribulations of charge- and credit-card company American Express, which issued a profits warning in July 2001, and said it would need to cut around 5,000 jobs. American Express predicts a gloomy 2002, and although it expects to remain profitable, those profits will probably be less than $700m.

In 2000, the world economy — around $31,200bn for the 65 leading economies — grew by 4.5%. 2001 will see a reduction, probably by around 1.8% as suggested by Merrill Lynch. This is still an increase, not an out-and-out contraction. For euroland, there is a particular dilemma: cutting interest rates from around 4.7% (money market rate, April 2001) would place the euro under pressure again. The currency staged a mini-revival in July 2001, following Ken Clarke's emergence as leading contender in the contest to lead the Conservative party, because he is a keen supporter of the euro. A weaker pound is of marginal help to UK exporters, and would probably increase consumer credit volumes, because the 'durables' to which the British are so addicted would go up in price — in general, the whole products, or their component parts, are imported. More credit would be bad news for long-term savings and investments, including stakeholder pensions.

Anyway, at present the stock market is too volatile for amateurs, who would rather bank on eventually inheriting their parents' home and using that as a cash engine for retirement.

The UK's 10 largest estate agents include CGNU (2nd), Royal & Sun Alliance (3rd), Halifax (4th), Bradford & Bingley (5th), Spicer Haart (6th), Skipton Building Society (7th), Reeds Rains (8th), Legal & General (9th) and Friends Provident (10th). The largest of all, Countrywide, has both AXA of France and Jupiter of Germany's Commerzbank as shareholders, each with over 10% of the equity. Until stockmarkets have settled down, property should be more popular with the public than equity-based investments.

SOCIAL FACTORS

Demographics

The whole issue of the ageing population has serious implications for future pension provision. The basic state pension has withered in real value since its link with earnings was cut. The State Earnings Related Pension, SERPS, was supposed to compensate, but in 1986 the Conservative Government announced that from 6th April 2000 the married couple's SERPS would be slashed in half as soon as one partner died. This received very little publicity, and, in March 2000, the Labour Government announced a postponement for two-and-a-half years, and promised compensation for SERPS contributors who can prove that they were misled.

Meanwhile, the Government is debating whether to raise the state retirement age for men and women to 70, a move which the National Association of Pension Funds (naturally) strongly supports. Population projections until 2026 show the extent to which a larger retired population will be dependent on a smaller working population. The Government has already taken steps to raise women's retirement age from 60 to 65, a change which is being phased in and will be fully effective from 6th April 2020. Early in 2001, the Government floated the idea of letting people postpone retirement and stay on at work for as long as they want — a probable preliminary to raising the age from which people can draw state pensions.

The British Government is following a very different path from the rest of the European Union (EU). In the UK, the onus for old-age provision has been thrust onto individuals. Elsewhere, the state plans to take much more of the strain.

The enormity of demographic change since the start of the 20th century is clear from Table 25. During the century, the number of people aged 65 and over rose nearly seven-fold.

Table 25: The UK Population by Gender and Age Group (million), 1901-1999 and Forecast to 2026

	Men			Women			All		
	Under 16	16-64	65+	Under 16	16-64	65+	Under 16	16-64	65+
1901†	6.29	11.47	0.74	6.11	12.41	1.18	12.40	23.88	1.92
1931†	5.75	14.80	1.55	5.52	16.56	1.92	11.27	31.36	3.47
1961†	6.38	16.82	2.30	6.01	17.47	3.82	12.39	34.29	6.12
1991	5.92	18.61	3.67	5.62	18.65	5.33	11.54	37.26	9.00
1999	6.15	19.34	3.81	6.04	18.72	5.44	12.19	38.06	9.25
2011	5.83	20.26	4.61	5.60	19.90	5.60	11.43	40.16	10.21
2026	5.78	20.22	6.10	5.49	19.70	7.11	11.27	39.92	13.21

†— age ranges are under-15 and 15 to 64 rather than under-16 and 16 to 64

Source:Social Trends 31, Table 1.3, 2001, National Statistics

The ratio of over-60s to others in the population is likely to become greater than 1:4 around 2020 — the year from which no woman will receive a state pension until they reach 65.

Table 26: Ratio and Forecast Ratio of Over-60s to All Others in the UK Population, 1996-2026

1996	1:4.9
2001	1:4.9
2006	1:4.7
2011	1:4.4
2016	1:4.2
2021	1:3.9
2026	1:3.6

Source:Government Actuary's Department figures, National Population Projections, June 1999, National Statistics/Key Note

There are already 2.5 million women aged between 75 and 89 in the UK, and 1.5 million men. In addition, 324,000 women and 89,000 men are aged 90 and over. By 2026, 614,000 people in the UK could be aged 90 and over.

Table 27: UK Population by Gender and Age (000), 1996-2026

	1996	2001	2006	2011	2016	2021	2026	% Change 1996-2026
Age 0-15								
M	6,205	6,180	5,983	5,766	5,683	5,676	5,686	-8.4
F	5,893	5,868	5,679	5,467	5,388	5,382	5,392	-8.5
Age 16-29								
M	5,720	5,332	5,411	5,593	5,561	5,359	5,183	-9.4
F	5,443	5,106	5,213	5,400	5,370	5,172	5,001	-8.1
Age 30-44								
M	6,538	6,989	6,797	6,194	5,813	5,912	6,056	-7.4
F	6,397	6,757	6,538	5,976	5,644	5,774	5,920	-7.5
Age 45-59								
M	5,270	5,594	5,982	6,381	6,813	6,628	6,052	14.8
F	5,312	5,633	5,973	6,279	6,624	6,405	5,862	10.4

Table continued overleaf...

Table 27: UK Population by Gender and Age (000), 1996-2026

...table continued from previous page

	1996	2001	2006	2011	2016	2021	2026	% Change 1996-2026
Age 60-74								
M	3,665	3,685	3,942	4,476	4,781	5,149	5,566	51.9
F	4,165	4,067	4,265	4,796	5,094	5,425	5,755	38.2
Age 75-89								
M	1,391	1,508	1,590	1,678	1,797	2,031	2,391	71.9
F	2,462	2,485	2,470	2,455	2,523	2,776	3,207	30.3
Age 90+								
M	67	89	104	118	139	160	184	174.6
F	273	324	340	351	374	394	430	57.5
Total								
M	**28,856**	**29,377**	**29,809**	**30,206**	**30,587**	**30,915**	**31,118**	7.8
F	**29,945**	**30,240**	**30,478**	**30,724**	**31,017**	**31,328**	**31,567**	5.4
All	**58,801**	**59,617**	**60,287**	**60,930**	**61,604**	**62,243**	**62,685**	6.6

M — male

F — female

Source:Government Actuary's Department figures, National Population Projections, June 1999, National Statistics

Between 1996 and 2026, an average fall of 7.5% in the 30 to 44 prime working age band is expected, while there could be a rise of 76.6% in men aged 75 and over, and 33% more women aged 75 and over. The forecast increases in the over-90s are even more striking: a near trebling of men over 90, and a rise of 57.5% in women nonagenarians. The elderly are a substantial new market for financial services, especially for schemes to augment pensions. Foreign companies seemed more aware of this than domestic ones, at least until the end of the 1990s.

The Rise of Lower-Income Customers

In May 2001, Abbey National, Alliance & Leicester, Barclays, HSBC, Lloyds TSB and Royal Bank of Scotland all agreed to link with the Post Office for a new card account available to those who are usually denied access to banking — the ‘socially excluded’. The participating banks will contribute around £180m to the costs of the account. The account will help the Government towards its objective of paying all state benefits into bank accounts, rather than paying cash at Post Office counters. The big banks have previously been rather reluctant to welcome benefit dependents as customers.

Those at risk of financial exclusion form a substantial, but, in the short term, not commercially rewarding, market. Of the six banks in the Post Office card scheme, Abbey National, Alliance & Leicester, Lloyds TSB and Royal Bank of Scotland already had special easy-access accounts, and so did the Woolwich, now part of Barclays. Bank of Scotland, Clydesdale Bank and the Halifax also provide basic accounts.

Four banking operations have established links with the Post Office to offer customers depositing and withdrawal services: Alliance & Leicester, Barclays, Co-operative Bank, and Lloyds TSB.

The Woolwich is working with local authorities and housing associations to give Open Plan current accounts to tenants. Housing officers have been given delegated authority to open accounts for tenants who have poor credit ratings or debts, and who would find it extremely difficult to open a standard account. The bank and the Treasury, which is working to reduce financial exclusion, hope to reach up to 20,000 tenants initially in six pilot areas. If successful, the scheme will become national. Open Plan is not designed specifically for people on low incomes, and already has more than half a million users, but is straightforward, and enables holders to qualify for companies’ discounts by paying by direct debit. The account does not include a cheque book, but offers a debit card.

Royal Bank of Scotland’s Key account is a basic account without a cheque book but with a Cashline card, access to Internet and telephone banking, and interest on credit balances. The Halifax’s Cardcash is a similar concept, plus a cheque book. It is available without credit scoring and with a deposit of £50. Bank of Scotland’s Easycash is another basic account with a cash card.

Alliance & Leicester’s focus on lower-income customers is not as deliberate as it was 3 or 4 years ago, and although the company still caters for them, it is also working to attract new high-income customers. It is adopting psychological profiles to improve its direct marketing, and is investing ‘tens of millions’ of pounds[1] in it.

PayPoint benefits the unbanked by offering bill payment terminals in around 7,500 shops. This is a real benefit for the millions of people who do not have cheque-book accounts. Cheque-cashing services are also useful for those whom, so far, the banks have not wanted as customers.

Lower-income customers provide an extensive customer base for companies offering home-collected credit, like Park Group and Provident Financial. Park

1. *‘Alliance & Leicester staffs up to run “psycho marketing”’, in Precision Marketing, 2nd March 2001.*

Group dipped into losses in 2000/2001, a negative £1.7m compared with a profit of £470,000 in 1999/2000. Net borrowings of £334,000 at the start of the financial year turned into a positive balance of £4.8m at the end of the year. Provident Financial continues to expand its home-credit business, in loans per customer rather than in customer numbers. During 2001/2002, the company is launching a home-shopping catalogue — like a reverse Great Universal Stores — and is devoting more effort to selling motor insurance through its agents. The catalogue business will be problematic to manage because the market does not really need a new one.

Provident's expansion into Eastern Europe has not been problem-free. In the Czech Republic, for example, bad debts reached 7.25% of credit issued. First-half results for 2001 showed continuing bad debt problems in Eastern Europe, and the company now expects annual earnings growth to be 4% at best.

TECHNOLOGICAL FACTORS

WAP

WAP (wireless application protocol) is supposed to be the future, which is why companies threw money at the Government to gain third generation mobile licences. HSBC is among the most enthusiastic of the banks about WAP, and its First Direct telephone bank has WAP services in London and South East England.[1]

Abbey National is not quite as enthused by WAP as HSBC is, but regards the Internet as so important that it is trialling two sites side by side, to compare customer response to each. The research is being undertaken by RedEye, which analyses customer relationship management.[2]

Online Technology

There are welcome signs that the personal touch is entering into online communications. Vavo's PolicySave.com searches the Web for the best insurance quotes for the over-45s, and also makes telephone searches if the Web trawl does not suggest prime possibilities. The Vavo service, which includes a facility for users to store all their financial data and to have a PIN number which they can lodge with their solicitor, has well over 350,000 members.

Value-added features are definitely needed because according to Internet analysts Gomez, during 2001, between 10% and 20% of the UK's online brokers may go bankrupt, be forced to sell out cheaply, or give up because of poor forward projections.

When online technology took off, many analysts expected that specialist Internet banks would develop. They have done so, but online banking is

1. 'First Direct extends "cost-effective" realtime banking to WAP phones', by Emma Rubach, 7th July 2001.
2. 'Abbey plans boost for Web operation', by Glen Mutel, MAD, 13th April 2001.

largely the province of traditional banks, which use the Internet as an additional distribution channel. A report by Thomson Intermedia in April 2001[1] found that stand-alone Internet banks have been spending more on advertising than the online arms of traditional banks, but have been recruiting fewer customers. The report suggests that stand-alone Internet banks spent an average of £6.3m on press advertising in 2000, while the High Street banks spent only £1.9m each, on average, on their online services. However, around three-quarters of recruits to online banking opted for their existing bank's online service, instead of signing up with a dedicated online bank like Egg (controlled by the Prudential), First-e, or the Halifax's IF (Intelligent Finance).

Egg is now seeing a return for its marketing investment, winning almost 225,000 new customers in the first quarter of 2001, a 14% rise. Customers are buying more products as a result of cross-promotions. However, Egg is still losing money — £37.9m in the January to March quarter.

The High Street banks are capitalising on their great advantage — physical visibility — by bringing online terminals into branches, so that customers without Internet access at home can log on. Forrester Research[2] argues that bank staff will become more skilled, offering advice, while cashiers' jobs will continue to disappear as routine transactions become automated.

1. 'Stand-alone web banks lose out to the big four despite major ad pushes', by Lucy Dixon, MAD, 23rd April 2001.
2. 'Banking on Internet services' , by Charlotte Hamilton, MAD, 26th April 2001.

10. Consumer Dynamics

A BIRD IN THE HAND AND A FOOT IN THE BRANCH... FOR NOW

Remembering the proverb ‘A bird in the hand is worth two in the bush’, British savers have in recent years been opting for short-term windfalls at the expense of long-term benefits, and so have been happy to see mutual organisations float on the stock market. The remaining building societies and other mutuals are able to offer cheaper mortgages and better rates on investments because they do not have to pay dividends to shareholders. Yet there are still ‘carpetbaggers’ who would like Standard Life, for example, to float, and who would like the Nationwide, Chelsea, Skipton, and the few other surviving large building societies, to demutualise and share out the capital value between the members.

Customers like windfalls, and they also like branches, but not as much as they used to do.

A MORI study for Nationwide in spring 2001 found that 11% of current-account holders banked online — around 4.3 million people — but 80% of them also visit branches. Customers are still reluctant to place all their trust in virtual entities, and find branches reassuring, according to Steve Clode, Marketing Director of Nationwide.[1]

In 1999, a Key Note commissioned survey by NOP asked about the importance of accessible branches. In 2001, Key Note added the word ‘local’. There appears to be a dramatic fall in people’s assessment of the importance of companies having accessible branches, from 80% in 1999 to 30% in 2001. A fall in the proportion of people saying that branches are important is likely because of the growth in telephone and online transactions — but it would be very surprising if this has caused a decline of 50 percentage points in 18 months. Other major reasons are likely to include the change in the wording of the question, with the addition of the word ‘local’, as well as NOP’s change of survey method from telephone to face-to-face interviews.

CONFUSION REIGNS AMONG THE ELDERLY

An NOP survey for Key Note in 2000 — see Key Note’s Market Assessment report *Financial Services Marketing to the Retired and Elderly* — revealed that more than 70% of the over-65s were very confused by the range of financial products on offer, and by the marketing techniques employed. They were most reluctant to buy financial products and services by phone (only 6% would do so) or over the Internet (only 2% would do so), and 75% said they would like to have a face-to-face meeting with the product supplier. Just over half thought that independent financial advisers (IFAs) offer unbiased

1. *‘Online bankers still want high street branches’, MAD, 26th April 2001.*

information, but barely a quarter would pay for financial advice. Only 13% would be prepared to buy a financial product from a supermarket.

The 55 to 64 age group was very keen on buying direct from the product supplier, 70% saying they would opt to do this, slightly more than the 66% of the over-65s. They too found the range of financial products and the ways they are marketed all very confusing, but to a slightly lesser extent than the over-65s. In the 55 to 64 band, 69% were confused both by the variety of products and the ways they are marketed. They had as much confidence as the majority of other respondents in buying by phone, but were still nervous of the Internet; only 5% would consider buying a financial product online. More than two-thirds would want a face-to-face meeting with the product supplier. They were happier than the over-65s to buy financial products from supermarkets, 20% saying they might do so, compared with 27% for the whole sample of all ages.

The survey revealed widespread confusion about financial services among all age groups: 71% of the whole sample thought that there were too many versions of products, and 69% said that the marketing of financial products and services confused them. The particular uncertainty among the over-65s indicates that companies need to simplify information — or at least the presentation of information, because FSA rules require companies to give a huge amount of detail.

ADVANCE OF ONLINE BANKING

A survey, by BMRB International at the end of February 2001, found that over a third of adults in the UK used the Internet that month — rising to nearly two-thirds of 15 to 19 year-olds, but including a mere 5% of the over-65s. In the previous 6 months, 47% of all users had bought a product or service online, almost 17% of the adult population. More than half of all those in socio-economic groups AB, the professionals, had logged on, but barely more than 10% of those in group E, generally the poorest, had done so. Online distribution favours the wealthier socio-economic groups.

In 1999, Key Note asked whether the interviewee had arranged insurance, savings or investments by Internet. In 2001, Key Note asked two questions about use of the Internet: whether people had used it to buy financial services, and whether they had used it to pay for products and services generally. For further detail, see Key Note's 2001 Market Assessment reports *Financial Services Marketing to ABs* and *Financial Services Marketing to C1C2DEs.*

The differences in wording mean that the findings are not directly comparable, but they do suggest a rapid increase in Internet use for all but DEs. In 1999, just 2% overall said that had used the Internet to arrange insurance, savings or investments. By 2001, 4% overall had bought financial services over the Internet, and 11% in total had used it to pay for products or services.

A huge gulf has opened up between the ABs and C2DEs in Internet usage. Only three DEs and eight C2s in 100 say they have paid for anything at all online, compared with 17% of C1s and 23% of ABs. Only two DEs and two

C2s in 100 have used the Internet to buy financial services online, in comparison with 6% of C1s and 9% of ABs. The C1s have taken to the Internet more readily than the C2s because of the types of jobs they do. C1s working in call centres and offices have to be familiar with new technologies.

The Internet users are spread across all age bands up to 65 and over, with a bulge at 25 to 34 years-old. Full-time workers (22%) are keener than part-time workers (11%) on using the Internet to pay for products and services, and it follows that men (full-time workers more often than not) use the Internet more than women (who account for the majority of part-time workers): the percentages are 14% of men and 9% of women.

The Internet is not cheap. One problem is the complexity of cost. BT's much-publicised fixed-price services in conjunction with a range of ISPs (Internet service providers) are more expensive than originally advertised. Telephone-service packages which include Internet use at least come at a known cost, but the prices are rising quite steeply, and this will put off lower-income customers.

While wealthy customers often prefer online banking, with the branch as a back-up, the less affluent tend to prefer branch-based banking, creating a problem for companies that want to close branches, but face Government opposition to one of the results — the erosion of banking services for the less affluent. Partnerships with the Post Office are one answer: Alliance & Leicester, Barclays, Co-operative Bank, and Lloyds TSB all have payment and withdrawal agreements with the Post Office at present.

WHO LOVES A CALL CENTRE?

Fewer than one person in six prefers to telephone a call centre instead of a local branch, according to Key Note's 2001 Market Assessment report *Call Centres*. Men are slightly keener on call centres than women: almost one man in five prefers to ring a call centre over a branch, but less than one woman in eight. This may reflect men's liking for the female voices they often hear when they ring call centres. The striking finding, though, is the continuing strong preference of men and women for speaking directly to a branch of the company or organisation they wish to contact.

The trend towards direct insurance online and by telephone threatens to limit the insurance market. Computerised web-site decision trees, and call centre agents following prompts, do not have the flexibility to take individual circumstances into account. Automated systems are cheaper for the companies to run in the short term, but at the risk of denying insurance to careful customers who do not fit the closely defined parameters set by the companies. Emphasis on short-term profitability can damage long-term customer relationships.

Young people accept the concept of call centres more readily than the over-55s, but the 15 to 24 year-olds (16%) like them less than the 25 to 34 year-olds do (24%). Only one in 11 or 12 of the over-55s would rather ring a call centre than a branch. There is relatively little difference between socio-economic groups, although the C1s have a little more time for call centres than other groups do, probably because work as a call centre agent is classed as a C1 occupation and so the group is likely to include some call centre workers.

Full-time workers are a little more likely than part-time and non-workers to prefer ringing a call centre. The very highest level of acceptance, exactly one in four, is in Scotland, where call centres are particularly important in the economy. Southerners really dislike call centres; only one in 11 of them prefers to ring one instead of a branch.

Call centres may cut organisations' costs but they are failing to be friendly and welcoming enough. The public ring them because increasingly they have no choice. The great majority, more than six people in seven, would rather speak to people in a local office or branch.

When developing their customer relationship strategy, financial services organisations need to consider how to make a call centre simulate the caller's local branch. This would make callers feel more at home.

SAVINGS SINK

Cheque-book accounts are on the wane. The 1999 NOP survey suggested that 84% of adults had a cheque-book account, but this fell to 75% in 2001. The proportions of ABs with a cheque book seemed barely to have altered. The big falls appeared to be among the under-35s. In 1999, 70% of 15 to 24 year-olds said that they had a cheque-book account, down to 58% in 2001, and the 91% of 25 to 34 year-olds who claimed a cheque-book account in 1999 has declined to 78%. By far the biggest decline appeared to be among DEs, from 72% with a cheque book to 56%.

The survey indicated a big fall in savings accounts, from three-quarters of the population in 1999 to 60% now. This reinforces the national statistics showing the low level of household savings in the UK. The decline in savings accounts appears to be particularly acute among the under-25s, from around eight in ten to well under six in ten. This links with the expansion of numbers in higher education and their greater poverty, following the axing of maintenance grants and the introduction of tuition fees. On the other hand, there are tentative signs that today's young people have better money sense than their elders. A Money Channel survey of people using the Internet portal Lycos found that two-thirds of the 15 to 34 age band want to save more in 2001 than they did in 2000.[1] Whether they will or not remains to be seen, but it suggests greater realism. If banks can encourage savings, the under-35s should be receptive.

The proportions of CDEs with savings accounts have fallen faster than the proportions of ABs. In 1999, a similar survey found that 79% of C1s had a savings account, 74% of C2s and 68% of DEs. These levels have fallen to 69%, 59% and 43%. The decline is sharpest among the DEs. In contrast, there has been an apparent fall of only five percentage points in the percentage of ABs with a savings account.

1. *'Youngsters keener to save than oldies', MAD database, 15th February 2001.*

Households with two or more cars are much more likely than those without a car to have a savings account, 70% compared to 45%. Owner occupiers are more inclined than council tenants to put money into savings accounts, 68% to 38%.

In 1999, NOP found that more than a third of ABs and more than three in ten C1s had borrowings exceeding their savings, compared with little more than one in five C2s and DEs. Those with children were nearly twice as likely as those without to owe more than they had saved.

In 2001, Key Note asked whether people's borrowings excluding mortgages were greater than their savings. This shows that approaching one in five, 18%, of all people aged 25 to 34 has borrowings greater than their savings, after removing mortgages from the equation. ABs are also heavily indebted, with almost one in eight owing more than they have in savings.

The pattern of net indebtedness reflects the easy credit offered to those in regular employment. One in seven of those working full time owed more than they have saved, and one in nine of people in households with two or more cars. The heavy costs of children are evident, because nearly one in eight of households with children had saved less than they owe. Men were 50% more likely than women to have debts greater than their savings — nearly one in ten, compared with little more than one women in 17. Only 3% of those not working owed more than they had saved. People living in council homes very rarely had net debts, only 2% in the sample, compared with 9% of owner-occupiers and 10% of those in private rented accommodation. The factors at work include the relative ease with which home-owners can obtain credit secured on their property, and the older age profile of council tenants. Lenders are reluctant to give loans to the retired who lack assets, for obvious reasons.

There are big regional differences: the proportions of people owing more than they have saved are around twice as large in the South than in the North — and in London are more than five times larger than in Scotland. The gap between annual incomes and home prices is far greater in London and the South East than elsewhere, and this intensifies the financial pressures on people who live there.

Net indebtedness is useful for some interest groups and worrying for others. Employers can benefit if their workers have high debt levels because it is very important for those workers to keep their jobs so they can repay their borrowings. Companies offering loans, credit card services and loan repayment insurance have a strong need to sell new debt, to keep their customers tied in.

On the other hand, social security ministers have an interest in encouraging people to save so that in later life they will be less likely to call on social security benefits. Individuals who have built up large savings have more economic options open to them. They can retire early, they have a financial cushion in case of hard times, and if they find their job intolerable, they may feel less pressure to keep it.

FEWER CARDS BUT MORE CREDIT?

In 1999, half the women in the NOP survey, and nearly two-thirds of men, had a credit card. The proportions appear to have fallen in 2001, to just under half and just over half, respectively. This conflicts with the national statistics for rising levels of consumer credit. The factors at work are likely to be greater use of cards by those who do have them, and the impact of NOP's changed survey method.

The proportion of ABs with at least one credit card in 2001 was almost the same as in the 1999 survey, 73% compared with 74%. Well over half of C1s and C2s, 61% and 56% respectively, and over 40% of DEs, said they had a credit card in 1999. In 2001, the C1s appeared to have the same level of credit card ownership, while only 51% of the C2s and 28% of DEs said they had one. Thus, as for mortgages, the steepest apparent fall in credit-card usage has been among the least affluent group, DEs.

Owner-occupiers were still much more likely than council tenants to have a credit card, and the gap appears to be widening. Almost two-thirds of owner-occupiers, 64%, admitted to a credit card in 2001, four percentage points up on 1999, while the percentage of council tenants with a credit card seemed to have fallen from 31% to 25%. This links with Inland Revenue statistics on the distribution of wealth, which also show a growing gap between wealthy and poor households. Key Note's own data shows that just on three-quarters, 74%, of people living in households with two or more cars had a credit card in 2001, compared with less than a quarter, 23%, of people in no-car households.

Debt management company Baines & Ernst, which spent nearly £7m on advertising in 2000, according to ACNielsen MMS, is a prime example of the businesses selling debt refinancing. The advertisements convey the idea that the company's financial skill will reduce customers' debt repayments, but the real skill at work is marketing. The company charges a 15% management fee for acting as a buffer between borrower and lender. For the foreseeable future in the UK, credit and credit management will be dynamic business sectors.

FEWER MORTGAGES?

Back in 1999, 40% of NOP survey respondents said they had a mortgage: more than half of ABs and C2s said they had a mortgage, just over 40% of C1s but not much more than a fifth of DEs. Mortgage holding was similar across most regions.

However, results from a 2001 survey suggest that mortgage holding has eased back, mainly due to fewer over-35s and ABs having mortgages. This odd finding could be due to differences in the sample. It could also be due to confusion over the meaning of 'mortgage' now that all-in-one current, mortgage, savings and loan accounts are gaining ground so quickly.

One very significant factor, which impacts on all the comparisons between 1999 and 2001, is a fundamental change in NOP's survey method. In 1999, all interviews were by telephone. In 2001, they are face-to-face. It is possible that interviewees may be more honest when speaking to an anonymous person over the phone than they are when replying to probing questions from a real person sitting next to them. On the other hand, face-to-face interviews enable interviewers to 'categorise' their respondents with greater accuracy, and to check that questions have been properly understood. When comparing the 1999 findings with the 2001 results, it is important to remember the major change in survey method.

If we take into account the confidence limits of the data, we can say that levels of mortgage-holding have not changed much among ABs, C1s or C2s, but that they are lower among DEs. Rising house prices make home purchase more difficult for poorer households, and for households composed of older people who have not owned property before, and who do not benefit from inheritance.

Fewer people in 2001 than in 1999 admitted to a loan other than a mortgage, 18% compared to 26%. The apparent fall was much more marked among C1s and DEs than among ABs. In 1999, just under 30% of ABs said they had a loan other than a mortgage, and 2001's NOP survey suggested that the proportion had fallen to under 25%. This finding is odd, considering the huge sums pumped in to advertising personal loans, and also taking into account the numbers whose borrowings exceed their savings.

The biggest falls in 'ownership' of loans appears to be among the 25 to 34 year-olds, down 17 percentage points, and 55 to 64 year-olds, down 12 percentage points. This could be due partly to differences between the samples and partly to the blurring between categories of financial products, including greater use of flexible mortgages which function as all-in-one current and loan accounts, and which are not categorised as loans. Innovative ventures like Virgin One show that there is still room in financial services for new companies with products that make life and money management easier for customers.

PENSIONS INDIFFERENCE

In 2001, there is no sign at all that people are heeding the Government's advice to take out a stakeholder pension. An NOP survey for Key Note found that only 2% of adults said they intend to have a stakeholder pension: 3% of men and just 1% of women. Single people, full-time workers, and those living in private rented accommodation appeared marginally more interested in stakeholder pensions than the population at large. Only two ABs in 100 said they planned to have a stakeholder pension. This is perhaps not surprising because ABs in work are likely to be covered by company pension schemes. Stakeholder pensions are intended to appeal to people on low incomes and those who do not work — more DEs than ABs, but only one DE in 100 intended to start a stakeholder pension.

Stakeholder pensions were launched in April 2001. They are the result of a Government initiative to try and persuade people to save more — a lot more — for their retirement.

There is plenty of scope for further expansion in personal pensions, if public confidence can be restored. Confidence in companies selling pensions is very low, following the publicity given to the misselling of personal pensions, Equitable Life's decision in July 2001 to wipe 16% off fund values, and the annuities issue. All personal pensions have to be traded for an annuity by the time the holder is 75, and annuity rates are only half those prevailing in the early 1990s.[1] Since 1995 the number of annuities purchased each year has slumped by over 40%, to 14,000 in 1999. The newly retired are turning to income drawdown from their pension funds instead: the number of such arrangements in 1999 was 18,000, up from 10,000 in 1996. Income drawdown is just a temporary solution, however, because of the need to convert the pension fund into an annuity by age 75.

Equitable Life was the major advertiser of personal pensions in 2000, but its commitment to pay guaranteed annuities proved too expensive — nearly £1.6bn — and it closed to new business on 8th December 2000. It suspended bonus payments on with-profits policies, and slapped a 15% penalty on transfers, and so there were around a million disgruntled policyholders — before the company slashed 16% from the with-profits fund.

INSURANCE DOLDRUMS

The 2001 NOP survey suggested that just over one person in ten overall had private health insurance: almost a quarter of ABs, around one C1 in eight, one C2 in 12 and one DE in 25. Between 13% and 15% in each age band from 25 to 34 years-old to 55 to 64 years-old contributed to private health insurance. Fewer than one in 14 of the over-65s did so, because premiums for pensioners are so high. Private health insurance has been in the doldrums for some years, and as yet there are no signs of revival.

Government statistics[2] put the number of employees and directors with private medical insurance as a occupational benefit at around 1.92 million in 1998/1999, over 20% of whom earned more than £45,000 a year. Company directors account for around 13% of all those with private medical insurance as a 'perk'.

The number of people with home buildings insurance also appears to have fallen since 1999, from 64% to 49% in 2001, but in this case there are a number of valid reasons. The proportion of ABs with buildings insurance has eased down to 75% from 81%, and the proportion of C1s with buildings insurance appears to have risen marginally to 57%, but C2s and DEs both seem less likely to have buildings insurance than in 1999. Many DEs live in rented accommodation, which the landlord is usually responsible for insuring. Older DEs in their own, fully-paid-for homes have been badly hit by rising premiums, which are largely a consequence of increasing environmental hazards such as flood damage. Some properties near rivers are now virtually uninsurable.

1. The best annuity rate for a man aged 60, as at 15th March 2001, was 7.86% — but this is for a level annuity without guarantee, i.e. the annuity does not rise from year to year, and ceases when the policyholder dies. The rates for an annuity increasing at 5% a year was less than 4.71%. Data from Moneyextra.com.

2. Social Trends 31, 2001 (Table 5.11).

Environmental changes are resulting in more frequent damage to property, which must push premium levels upwards. Only affluent ABs can view this without real financial worry, but often ABs can afford to buy properties which are relatively safe from foreseeable natural hazards.

Home contents insurance has also fallen back since 1999, from 71% overall to 64%, although not for ABs. Then, as in 2001, 80% held contents insurance. The proportion of C1s with contents insurance has also held steady at 72%. Fewer C2s had contents insurance in 2001, 67% to 76%, but it appeared that DEs have been responsible for the lion's share of the decline, from 61% to 44%. Rising premiums, a consequence of thefts and environmental damage, notably flooding, appear largely to blame.

Some of these excluded customers would create losses for insurers, suggesting a need for a state-subsidised insurance scheme for high-risk properties. Local authorities have responsibilities here, because of the frequency with which they have granted planning permission for new developments on unsuitable sites, and in flood plains have not insisted on measures such as raised floor levels and lower storeys made of materials resistant to water damage.

FLEXIBLE ACCOUNTS AND CLEARER INFORMATION

The consumer research indicates that insurers will have difficulty in expanding the domestic market profitably, and that huge damage has been done to the pensions business. Flexible all-in-one accounts, which can link cash, mortgages and personal loans, have become popular very quickly. Credit and credit management will remain growth sectors, as customers prefer tangibles today to uncertainties tomorrow.

Customers are getting used to the disappearance of branches, and are quickly accepting online banking — except the less affluent. Call centres need improvement because they are often not at all user-friendly. The elderly, especially, find product information confusing, so it would be a good idea for companies to present essentials in clearer language.

11. Company Profiles

INTRODUCTION

Here we give summary profiles of the top dozen financial services companies in the UK, by market value. The Bank of Scotland and the Halifax have been counted as one, HBOS, on the basis that their merger is likely to proceed unhindered. The emphasis is on developments in the UK, in the context of global operations.

HSBC

Corporate Strategy

HSBC — the Hong Kong and Shanghai Banking Corporation — has its origins in South East Asia and is looking to further expansion there. The bank has 6,500 offices in 79 countries, is listed on the London, Hong Kong, New York and Paris stock exchanges, and has 190,000 shareholders. The strategy is to strengthen its position as a truly global bank. The multinational composition of the board supports this aim.

Advertising and Distribution

HSBC will continue to develop multiple delivery channels, what it calls 'clicks and mortar'. HSBC had 1,668 branches in the UK at the end of 2000, just 2% less than in 1995, compared with a near-20% fall overall for all the members of major British banking groups. The largest supermarket chains, Tesco and Sainsbury's, had already linked up for banking services with Royal Bank of Scotland and Bank of Scotland respectively, but HSBC found a satisfactory alternative with the successful Yorkshire-based chain Morrisons.

In the UK, HSBC is promoting the concept of portable bank accounts, and is looking to increase its knowledge about customers so that it can target them with product information at appropriate times.

Retail discounts, competitions and special offers are tailored to the spending patterns of individual credit-card holders, in a bid to increase the usage of each card, rather than a push to gain more customers. HSBC has around 2.5 million credit-card customers in the UK, and this number has not materially altered since 1999.[1]

During the year to end June 2001, HSBC spent £6.1m on advertising general banking services in the UK, and £2.1m on advertising for general mortgages, a sector in which the bank is keen to expand.

Globally, the bank seeks to associate its brand with integrity, trust and excellent customer service. A new branding campaign meets international

1. *'HSBC unveils revamped credit cards', MAD, 26th April 2001.*

travellers in the jetties and corridors at Heathrow, Gatwick and Stansted, where more than 100 million people a year will see them. The HSBC symbol is promoted internationally on TV, cinema, posters, and in print media. The bank believes that its values are encapsulated in motor racing, and sponsors Jaguar Racing in Formula One.

Profitability

The share price suffered in the early months of 2001 because of nervousness about prospects in Asia and the US, and concerns about a possible rise in bad debts, although bad debt charges more than halved between 1998 and 2000. HSBC has served as rather a safe haven in turbulent times for investors, who just need to watch that the bank does not become disproportionately involved in the world's more volatile markets. The largest single investor (at the end of June 2001) was the Hong Kong Monetary Authority, with 4.01% of the equity, and thus a fairly strong Chinese influence on future development. Barclays was the second largest investor, with 3.87% of the equity, and a British factor in executive decisions.

Pre-tax profits recovered strongly in 1999 and 2000 from a dip in 1998. The bank has increased dividend payments annually, in 2000 by nearly 38%, to help keep the support of shareholders despite some tricky trading conditions outside the UK. Brokers are bearish about HSBC's prospects, mostly advising investors to hold rather than to increase their stakes, but ING Barings Charterhouse, with recommendations on 1st June 2001, advised selling. Analysts' estimates of pre-tax profits for 2001 range from £5bn to nearly £10bn — which is quite a wide spread. The signs so far seem to support Prudential-Bache's forecast of around £7.2bn, taking into account growth through acquisition offset by the negative impact, spreading from the US, of slower trading conditions.

Table 28: HSBC's Financial Performance (£m, pence and %), 1996-2000

	1996	1997	1998	1999	2000	% Change 1996-2000
Pre-tax profits (£m)	4,524	4,935	3,962	4,949	6,544	44.7
Normalised earnings per share (pence)	36.1	38.2	31.2	38.1	52.7	46.0
Dividend per share (pence)	13.7	16.7	18.9	21.1	29.1	112.4
Market capitalisation (£m)	34,146	40,697	41,997	72,993	91,292	167.4

Source:Hemmington Scott/Key Note

Future Company Developments

A further shift of emphasis towards the Far East would fit with the bank's long-term ambitions. Already there are global processing centres in Guangzhou, China, and Hyderabad, India, which are to be expanded. The bank suggested in its 2000 Annual Report that it would be battening down the hatches, because 'competition in the UK shows no sign of abating, and structural changes here and in Hong Kong… suggest a testing environment ahead'. In Hong Kong, the bank has already had a major success with the new compulsory retirement savings fund, recruiting 580,000 savers, and its strength in the former British colony, now part of China, is likely to deepen. Elsewhere, the outlook is mixed.

HSBC Private Equity has a thriving business buying and selling companies. In July 2001, for example, it sold Mira Showers to Kohler Corporation for just over £300m — after buying parent group Caradon Plumbing for £420m in November 2000. This type of activity, in the tradition of trading companies like Hanson, perhaps indicates a trend in banking to focus more on buying and selling companies — asset stripping or the creation of added value, depending on your point of view. Royal Bank of Scotland announced in July 2001 that it is planning to acquire automotive components and aircraft systems manufacturer BritaX International — another pointer to this trend.

Like virtually every bank, HSBC has hit upon the wealthy as a vital business sector, and is developing HSBC Premier as a wealth management service. HSBC's global scale is helpful here, for those clients who likewise have assets and income scattered over the globe, and the bank's aim of being in the world top five for private banking is not far-fetched. By 2001, the service had 270,000 clients served from more than 100 centres.

On the commercial side, Internet business banking is likely to expand beyond the UK, US, Canada and Hong Kong. A finance initiative for Islamic countries could help the bank to grow in those countries, where interest payments are not permitted under religious law.

Greater involvement in Europe is likely, following the acquisition of Crédit Commercial de France (CCF) in 2000, as a platform into the Euro zone. Expansion in the developing world is likely to follow the pattern of 2000, when HSBC acquired PCIB Savings Bank in the Philippines, Chase Manhattan in Panama, and an additional 50% of Egyptian British Bank, taking the stake to 90%.

ROYAL BANK OF SCOTLAND

Corporate Strategy

Shareholders have applauded Royal Bank of Scotland's innovation and dynamism, from the launch of the first big direct insurer, Direct Line, to its partnerships with Virgin Personal Finance for remote banking and Tesco Personal Finance for supermarket banking. The scale broadened in the first quarter of 2000 with the acquisition of National Westminster, which gave Royal Bank of Scotland High Street branches across the UK. NatWest's Marketing Director Frazer Smith left in spring 2001 to join the American card company Capital One, and Royal Bank started to rethink its marketing strategy.

The bank includes Angel Trains and the roadside rescue organisation Green Flag, neither of which fit the traditional notion of a bank. There are extensive interests in the US — the Annual Report for 2000 points out that Royal Bank of Scotland is the 'only UK bank to have been consistently successful in the US' — and in the 1990s, the bank increased its market capitalisation from £1.2bn to £42.4bn at the end of December 2000.

Advertising and Distribution

During the year to end June 2001, Royal Bank of Scotland was one of the UK's leading advertisers of credit cards, spending around £3m, approaching 5.1% of the total for credit cards. The Direct Line subsidiary put £7.9m into advertising motor insurance, almost a fifth of the total for that category. NatWest was the leading advertiser of general banking services, with an expenditure of £19.8m, 44.3% of the category total. Lombard Bank/Direct, which came with NatWest, was the top advertiser of unsecured personal loans, spending over £11.9m, according to ACNielsen MMS — 33.7% of the category total. Direct Line was the third largest advertiser in this category, with a spend of £3.9m, so Royal Bank of Scotland was responsible for more than 40% of all advertising for unsecured personal loans. With the passing years, Royal Bank of Scotland has focused more and more on credit and loans.

The bank is testing the water for interactive TV, in a venture with Matching Hat's YmiTV. However, money channels on interactive TV are proving slow to catch on because they are often rather dull and repetitive.

The aggressive insurer Direct Line, the first of the major direct insurance sellers in the UK, is expanding into Europe with the purchase, announced in June 2001, of US corporation Allstate's motor insurance businesses in Germany and Italy. The German arm has 117,000 current policies, and the Italian one, which was only launched in April 2000, has 27,000. Allstate will adopt the Direct Line brand and red telephone symbol. Direct Line already owns Spain's largest direct motor insurer, Linea Directa, which has over 300,000 policies. The total motor insurance market in Germany is more than a third greater than in the UK, and the Italian market is nearly 10% larger. Allstate itself does not believe that its European businesses fit into its future strategy.

The Royal Bank of Scotland branch network has fallen much faster than HSBC's, by 21% since 1995 to 2,291. Most of the fall has been in National Westminster branches — but this still gives Royal Bank the second most extensive network after Lloyds TSB, narrowly ahead of Barclays/Woolwich. In addition, the joint venture with Tesco, which takes in the insurer Direct Line, extends the bank's influence into the UK's largest supermarket chain.

Profitability

Royal Bank of Scotland's popularity with investors shows few signs of diminishing in the first half of 2001. Brokers are still suggesting that the shares are a good buy. Most expect earnings per share to exceed 120 pence in 2001, and the dividend to exceed 38 pence, and they expect pre-tax profits to continue rising in 2002, towards £6bn — compared with less than £700m in 1996. The share price proved largely resilient in the first 6 months of 2001.

Table 29: Royal Bank of Scotland's Financial Performance (£m, pence and %), 1996-2000

	1996	1997	1998	1999	†2000	% Change 1996-2000
Pre-tax profits (£m)	695	760	1,001	1,211	3,373	385.3
Normalised earnings per share (pence)	37.2	39.1	57.3	69.5	110.0	195.7
Dividend per share (pence)	17.2	19.8	22.8	26.4	33.0	91.9
Market capitalisation (£m)	3,971	5,911	5,867	11,621	42,370	967.0

† — 15 months

Source:Hemmington Scott/Key Note

Important shareholders include Banco Santander of Spain, with 9.62% (27th June 2001) and the merged insurer CGNU with 3.41%.

Future Company Developments

Where does Royal Bank of Scotland go from here? Expand into Europe with Banco Santander? Extend its American activities through Citizens? It needs to look abroad because the scope for further domestic growth is limited, especially now that it has linked with the biggest insurer (and significant shareholder), CGNU, for a bancassurance joint venture. Does it really want to become a transport services company, as implied by Angel Trains and Green Flag? The problem is that Royal Bank has expanded so quickly from a niche bank to an international force, that if the pace slows down analysts may feel that the spark of dynamism is fading.

During July 2001, the bank was reported to be in talks with Virgin to acquire Sir Richard Branson's 25% stake in the Virgin One joint venture, and possibly with AMP of Australia, which holds another 25%. Thus it seems that Royal Bank wants to own the whole of Virgin One, which has a rising share of UK mortgage lending, 3.5% in 2000. Sir Richard Branson appears most unlikely to sanction any substantial breakup on Virgin's personal finance operations, though. Virgin Direct and Virginmoney are to merge in 2002, as a step towards an international finance brand: Virgin products will be sold in Europe, and then probably South East Asia and Japan.

One answer to the question 'Where next?' was not long coming. On 17th July 2001, reports emerged that the bank is to buy, through Citizens, the retail banking business of Mellon Financial Corporation in the US, for about $2.1bn. To raise money for this and further expansion, the bank announced that it intends to raise around £2bn from shareholders through a new issue of ordinary shares. Mellon is based in Pennsylvania and has customers in surrounding states including New Jersey and Delaware. Royal Bank of Scotland is on its way to becoming a significant presence in the US, a market four-and-a-half times larger than the UK.

LLOYDS TSB

Corporate Strategy

Lloyds' prime objective is to maximise shareholder value over time, through leading in its markets, being selected as first choice by customers, and cutting operating costs. The overt focus on shareholders is not necessarily good news for customers, unless they happen to be shareholders too, because — as the mutuals never tire of pointing out — customers pay the shareholders' dividends.

Lloyds' ambition to be number one means that it has been eating up the opposition from its acquisition of TSB onwards. The Cheltenham & Gloucester Building Society and Scottish Widows have joined the stable. Lloyds was eager to add Abbey National, for which it made a hostile bid, but the Department of Trade and Industry (DTI) rejected the bid in July 2001. In the rush for growth, Lloyds appears to be in danger of forgetting that customers do not necessarily like monopolies.

Advertising and Distribution

Lloyds TSB was checked in one direction but is marching on elsewhere, for example, with a new interactive TV service with Telewest. Lloyds TSB's Head of E-Commerce, Mike Beaven, said, in May 2001, that the venture was to gauge customer interest.[1]

Lloyds TSB advertised its corporate identity extensively in the year to end June 2001, spending over £9m, according to ACNielsen MMS. This was followed by Abbey National at £5.5m, and Standard Life, at £5.4m, which fought an expensive battle to stay mutual. Lloyds was the third largest advertiser of online banking, with a spend estimated at £2.8m, compared with over £9.9m for Abbey National and its Internet bank Cahoot, and around £5.1m for Barclays. Scottish Widows headed the advertising for unit trust ISAs, splashing out £3.7m.

The group had 2,410 branches at the end of 2000: 2,013 Lloyds TSB, 187 Lloyds TSB Scotland, and 210 Cheltenham & Gloucester, a fall of 22% since 1995, but still large enough for effective national coverage.

Lloyds TSB is a household name, but its 'brand values' are elusive because the company emphasises figures rather than feelings.

Profitability

Pre-tax profits rose by 7.3% in 2000. This was much less than the bank would have liked. The reasons cited in mitigation include exceptional restructuring costs, compensation for misselling personal pensions, a charge for stakeholder pensions, changes in the economic assumptions applied to long-term insurance business, and the sale and closure of businesses.

During the year the bank acquired Scottish Widows and Chartered Trust, customers' deposits rose by 8% to £101bn and lending to customers increased by 12% to £114bn.

The bank has pushed the return to shareholders ahead of earnings per share, but was not able to maintain the share price in 2000, and it has lacked lustre in 2001, although in July had recovered to around 650 pence from an Easter-time low of 578 pence. Shareholders were not too sure about the bid for Abbey National, and the bank now needs a direction with a clear rationale other than to benefit shareholders — which should be the outcome of clever business management, not its prime purpose.

1. *'Lloyds TSB takes ITV route', MAD, 2nd May 2001.*

Table 30: Lloyds TSB's Financial Performance (£m, pence and %), 1996-2000

	1996	1997	1998	1999	2000	% Change 1996-2000
Pre-tax profits (£m)	2,505	3,162	3,015	3,621	3,886	55.1
Normalised earnings per share (pence)	32.3	39.6	36.9	47.9	53.1	64.4
Dividend per share (pence)	13.2	17.2	22.2	26.6	30.6	131.8
Market capitalisation (£m)	22,962	42,467	46,478	43,031	39,535	72.2

Source:Hemmington Scott/Key Note

The two leading shareholders are Legal & General Investment Management and M&G Investment Management, with 3.07% and 3.00% respectively (as at 27th June 2001). Neither holding is large enough to sway the board.

Brokers do not expect the dividend to rise significantly in 2001, and forecasts for 2002 are mixed. Dresdner Kleinwort has been bearish, predicting just a 2% rise in pre-tax profits for 2001, but Lehman Brothers were altogether bullish, suggesting a 16% rise. Both these forecasts predated the DTI's rejection of Lloyds' bid for Abbey National.

Future Company Developments

Lloyds feels there is money to be made from wealth management for the rich. So does virtually every other bank, of course. The Lloyds offering is called 'Create'. It comes with 'tailored independent advice', according to the 2000 Annual Report (p15), 'superior service' and a 'choice of investment options from quality providers', as well as a new 'Wealth Management Account' to consolidate all financial products into a single account. The bank has linked with Goldman Sachs for broking services to customers with the Wealth Management Account. The target is 250,000 customers by the end of 2002. The bank hopes that these customers will substantially augment the £300m operating profits from wealth management in 2000.

However, Lloyds needs to be more specific about the benefits to the affluent of entrusting their funds to the bank. The knowledge that they are contributing hugely to the bank's profits will not be enough.

Other prongs of Lloyds' strategy include expansion in motor vehicle finance (through Chartered Trust), in long-term investments (through Scottish Widows), and in online banking. Lloyds is not yet a truly international bank, and in future most its growth will need to be overseas because of political opposition to further expansion at home. In 2000, more than 88% of pre-tax profits were from UK activities: the 12% from overseas will have to grow, quickly.

Signs of an impending move overseas emerged immediately after the DTI blocked the bid for Abbey National, with rumours that Lloyds TSB was holding talks with Banco Bilbao Vizcaya Argentaria of Spain and Fortis of the Netherlands, about possible partnerships.

BARCLAYS

Corporate Strategy

Barclays may have been gnashing its teeth over Lloyds TSB's expansion ambitions, which made its recent 'big bank' advertising campaign look slightly less impressive. However, with Barclaycard, the bank does own Europe's largest credit-card business, although one which has been subject to strong pressure from North American card issuers.

Barclays now feels that it cannot afford to let up on its expansion programme, or it risks being left behind by HSBC, Royal Bank of Scotland, Lloyds TSB, and even HBOS, the emerging Halifax/Bank of Scotland. During 2000, Barclays acquired the former building society, the Woolwich, and, in 2001, is still looking for another purchase to counter Lloyds TSB's expansion rush. During May 2001, rumours spread that Barclays would make a friendly offer for Abbey National if the DTI rejected Lloyds TSB's hostile bid, which it did on 10th July 2001 — but if Lloyds' bid was not in the public interest, then it would be difficult to argue the contrary for Barclays.

Seeing uncertain prospects for expansion at home, Barclays is busy recruiting affluent European customers for its wealth management service — the new 'must have' market sector. Barclays Private Clients have average marketable assets of £350,000, and so far about a fifth of UK residents with this degree of wealth bank with Barclays, which aims to grow its share to over a third by 2005. Unfortunately, most other banks are also aiming in this direction, so growth in the UK may have to be by acquisition, if competition regulations permit. There is more scope to build this business in Continental Europe, where only 170,000 people are with Barclays Private Clients, but it is worth remembering that European wealth profiles are very different from British ones. Wealth is more evenly distributed, so the bulk of the population is moderately prosperous but there are few super-rich.

Information is at the heart of Barclays' strategy. The bank states in the 2000 Annual Report (page 6):

> "It is through continued investment in customer information systems, and the wealth of customer data that these provide, that the creation and development of the right products and services are achieved."

Advertising and Distribution

In the year to end March 2001, Barclays was the fourth largest advertiser in the ‘corporate’ category for financial services, spending £5.2m, around 7% of the category total, but behind Standard Life, Lloyds TSB and Abbey National. All three had pressing reasons for promoting their image and reputation: to stay mutual, to take over Abbey National, and to remain independent, respectively. However, ACNielsen MMS’s figures for end June 2001 indicate an enormous decrease in Barclay’s corporate expenditure, down to £756,000.

Barclaycard was by far and away the largest advertiser in the credit card category, spending over £14.6m, according to ACNielsen MMS. Online banking was also an important sector for Barclays, because its advertising spend was around £5.1m, 22.9% of the total, and second only to Cahoot/ Abbey National combined.

Barclays’ retail division sells Legal & General insurance and investment products, and Barclays’ customers can make deposits and withdraw funds at Post Offices nationwide. Barclays itself had 1,727 branches in the UK at the end of 2000, 16% fewer than in 1995, and the Woolwich had 402, 13% down.

Barclaycard has installed an automated call handling system for customer services which requires the caller to key in their card number, key in a passcode number, change the passcode number if the ‘voice’ so instructs, and to then repeat operations in the hope of eventually connecting to a real voice. The procedure is complex, likely to deter older customers, and does nothing for Barclaycard’s corporate image. Technology has been put before the customer. This too is a current trend. Companies risk being too beguiled by technology for the sake of it, not as a means to make customers more satisfied.

Barclays is busy integrating channels. The bank chose BT’s Syncordia Solutions to provide an Internet Protocol based network, which will enable all Internet communications to flow across all channels, including branches, ATMs (automated teller machines) and call centres. Customers will be able to make transactions by Internet including via WAP (wireless application protocol), digital interactive TV, telephone, ATM and branch. The operation of the new network, including UK and international communications, will be outsourced to Syncordia. This is a substantial example of the growing importance of outsourcing. The network will incorporate Voice over Internet Protocol supplied by Concert, BT’s joint venture with AT&T. Barclays also has a link with Internet service provider Freeserve for a co-branded portal in the Barclays consumer website.

Barclays is still heavily into technological innovation, and launched a mobile WAP banking, credit card and sharedealing service with Vodafone in May 2001. This is a long-term shot because WAP uptake is not as fast or furious as the phone companies had expected. The technology is clever, but is running ahead of people’s need for it.

Profitability

Barclays' lack of rapid expansion in recent years, especially compared with Royal Bank of Scotland, is evident from the profit and market capitalisation figures in Table 31, which convey steady rather than dynamic growth. The £1.7m paid to the Chief Executive, Matthew Barrett, in 2000, seems generous in the circumstances.

Table 31: Barclays' Financial Performance (£m, pence and %), 1996-2000

	1996	1997	1998	1999	2000	% Change 1996-2000
Pre-tax profits (£m)	2,306	1,716	1,895	2,460	3,496	51.6
Normalised earnings per share (pence)	103.0	107.0	89.4	146.0	163.0	58.3
Dividend per share (pence)	31.5	37.0	43.0	50.0	58.0	84.1
Market capitalisation (£m)	15,418	24,755	19,583	26,641	34,437	123.4

Source:Hemmington Scott/Key Note

During 2000, the Retail Financial Services performed well, with operating profit up 30% to £1.71bn. Barclaycard had a difficult year, with operating profit up just 4% to £418m. Barclays Capital and Barclays Global Investors more than compensated for this with rises of 30% to £403m and 51% to £65m respectively. Corporate Banking's operating profit rose 13% to £1.07bn.

Future Company Developments

Around 86% of the Barclays' profits come from the UK, and 11% from the rest of Europe. Barclays is not yet a world bank, or even a Continental bank, which it needs to become. Retail financial services supply almost half the profit, followed by corporate banking with over 30%. There is relatively little scope to expand in retail financial services in the UK, except at the fringes, without incurring a block from the DTI. The board does not yet have enough international representation. Chief Executive Matthew Barrett gained his previous banking experience in Canada, but the other directors have backgrounds which are overwhelmingly British. The planned overseas move announced towards the end of July 2001, for a joint venture with Canadian Imperial Bank of Commerce to create a new bank, First Caribbean International Bank, suggests that the Barclays board is benefiting from the Canadian experience of their Chief Executive. While Royal Bank of Scotland is becoming a UK-US bank, could it be that Barclays will develop a UK-Canada axis?

HBOS

Corporate Strategy

Preparations for the Bank of Scotland/Halifax merger to form HBOS were under way as this report was written in July 2001. The company started trading as HBOS on 10th September 2001.

The Halifax has concentrated on mortgage lending, and acquired another former building society, the Birmingham Midshires, signalling its intention to remain the leading mortgage lender. The Bank of Scotland arm of the new company performed strongly in corporate banking in 2000, expanded in Australia through BankWest, and proceded down the affinity route creating partnerships with AXA, British Gas, Royal & Sun Alliance and Saga, among others.

The range of expertise across the new board, to be headed by Dennis Stevenson as Executive Chair, Peter Burt, as Executive Deputy Chair, and James Crosby, Chief Executive, encompasses shipping, defence, electronics, transport, finance, utilities, property, building, management consultancy, media communications, and leisure. The nature of the board suggests that the new bank will seek to expand its role in business banking and in long-term insurance. The acquisition of assets from Equitable Life was already a pointer in this direction.

The fragmentation of the mortgage market, and the rise of all-in-one current, savings and mortgage accounts, suggests that Halifax is wise to diversify. It is still the UK's largest mortgage lender, with £96.3bn of mortgage assets at the end of 2000. Abbey National, in second place, had mortgage assets of £68.6bn.

Table 32 highlights the Halifax's dominance in mortgage lending, but also shows slower growth than for the other leaders apart from Alliance & Leicester. Bank of Scotland is the tenth largest lender, and when its mortgage assets are added to those of the Halifax they total almost £112bn, almost two-thirds more than Abbey National's assets.

Table 32: Largest Mortgage Lenders in the UK (£bn), 2000

	Mortgage Assets		% Change
	End of 1999	End of 2000	1999-2000
Halifax, including Birmingham Midshires and IF	93.0	96.3	3.5
Abbey National	64.9	68.6	5.7
Lloyds TSB, including Cheltenham & Gloucester	47.5	52.7	10.9
Barclays including the Woolwich	44.2	47.3	+7.0
Nationwide BS† (years to April 2000 and 1999)	36.7	41.1	12.0
Royal Bank of Scotland including NatWest, Direct Line and Virgin	*n.a.*	29.0	*n.a.*
Alliance & Leicester	19.4	19.4	0
Northern Rock	15.8	18.6	17.7
Bradford & Bingley	17.1	18.3	7.0
Bank of Scotland‡	13.7	15.6	13.9

n.a. — not available

Note: mortgage assets are residential mortgage balances outstanding including staff mortgages and securitised assets

† — years to April 2000 and 1999

‡ — years to February 2001 and 2000

Source:Council of Mortgage Lenders

HBOS will have a value of around £28bn, and will be more streamlined than the two separate banks, because around 2,000 staff will lose their jobs. Halifax shareholders will own 63% of HBOS, and Bank of Scotland shareholders, 37%.

Advertising and Distribution

Neither the Halifax or the Bank of Scotland invested heavily on corporate advertising in 2000, because they will need to create a new identity as HBOS. The Halifax did promote its credit cards strongly in the year to end June 2001, spending £4.6m. The Halifax also spent mightily on generic advertising for mortgages — over £3.8m in the year to end June 2001, according to ACNielsen MMS, more than any other mortgage provider.

The Halifax has carried out considerable rationalisation since 1995, closing well over 250 branches by the end of 2000. In 1996, the Halifax had 1,083 branches in the UK, and the Birmingham Midshires Building Society had 120. By 2000, the combined chains had 832 branches.

Bank of Scotland was down to 334 branches by end 2000, from 411 in 1995, but the bank's presence in Sainsbury's supermarkets makes up for the reduction.

Profitability

Back in 1996, Bank of Scotland was worth more on the stockmarket than Royal Bank of Scotland. In 2000, Royal Bank of Scotland's value was over four times larger than Bank of Scotland's. The non-royal bank had begun to look like a permanent runner-up, beaten in the campaign to take over National Westminster, creating a bank with the second-largest supermarket chain, Sainsbury's, while Royal Bank linked up with leading retailer Tesco. The bank has been marking time, rather, so the merger with Halifax offers a new and needed challenge.

Table 33: Bank of Scotland's Financial Performance (£m, pence and %), 1996-2000

	1996	1997	1998	1999	2000	% Change 1996-2000
Pre-tax profits (£m)	664	742	1,012	911	981	47.7
Normalised earnings per share (pence)	29.4	34.7	37.2	45.4	47.3	60.9
Dividend per share (pence)	8.2	9.9	11.6	13.5	15.3	86.6
Market capitalisation (£m)	4,081	8,499	11,185	7,074	9,845	141.2

Source:Hemmington Scott/Key Note

Almost a quarter of the equity is in the hands of six institutions. Schroder Investment Management has 6.58% (as at 28th June 2001); Scottish Widows Investment Partnership has 4.02%; Capital Group Co, 3.69%; Zurich Scudder Investments, 3.46%, Deutsche Asset Management, 3.08%; and Legal & General Investment Management, 3.01%. The merger should give a stronger growth platform and thus help the share value.

The Halifax has achieved good increases in pre-tax profits, and has retained share dividends at extremely prudent levels. Yet the company's equity value fell in 1999 and 2000, although has recovered in 2001.

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Table 34: Halifax's Financial Performance (£m, pence and %), 1996-2000

	†1996	1997	1998	1999	2000	% Change 1996-2000
Pre-tax profits (£m)	893	1,631	1,701	1,607	1,715	92.0
Normalised earnings per share (pence)	33.0	43.4	42.4	50.4	62.9	90.6
Dividend per share (pence)	*n.a.*	17.5	20.3	24.0	26.5	‡51.4
Market capitalisation 1997-2000 (£m)	*n.a.*	19,249	20,775	15,424	14,909	-22.5

n.a — not available

† — 11 months

‡ — % change 1997-2000

Source:Hemmington Scott/Key Note

Legal & General owns 3.03% of the Halifax (as at 28th June 2001) and BGI has 3.21%. Otherwise, shareholdings are widely dispersed. The Halifax has remained remarkably true to its building society origins, providing mortgages for home purchase. Linking with Bank of Scotland will bring experience in business and corporate banking as well as in retail financial services.

Future Company Developments

The future of both Halifax and Bank of Scotland is now being handed over to HBOS, a new national bank which should be market leader in mortgages. Fast expansion in short- and long-term savings is likely. Both the founder companies have respected brand names — not flamboyant or fashionable, but solid. That should be a great asset in the uncertain years ahead. In addition, Bank of Scotland's joint venture with Sainsbury's in Sainsbury's Bank, and the Halifax's online venture Intelligent Finance, provide non-traditional distribution channels which will be available to HBOS.

The Halifax is preparing to take a much bigger part in educating the young about personal finance, and has prepared an education pack called 'Fit for Finance', which it hopes to make available nationally, perhaps in a private-public partnership (with the DfES [Department for Education and Skills], the Scottish Parliament or Welsh Assembly or with local education authorities). This would raise HBOS's profile among the under-16s.

CGNU

Corporate Strategy

CGNU aims to grow globally in general insurance, long-term savings and fund management, and to be in the European top five in each market. The long-term insurance market, though, is more important to the company than general insurance.

Advertising/Distribution

In the UK, CGNU uses the Norwich Union brand, and distributes products through Royal Bank of Scotland/Natwest (which sold half of their life businesses to CGNU) and more than 20 building societies, as well as through IFAs and its own staff. HSBC also distributes CGNU products.

Norwich Union was the fourth largest corporate advertiser in financial services in the year to end June 2001, according to ACNielsen MMS, spending over £5.4m. Norwich Union was the principal advertiser in the category for general investment schemes, with an enormous £8.3m, 21.4% of the total spend in the category, and also put £2.5m into advertising unit trust ISAs, 9.2% of that category's total. The company has concentrated on advertising long-term products.

CGNU's annual report for 2000[1] notes:

> 'Our vision is to be a fully integrated, multi-distribution insurance company. Part of our commitment to exceeding customer expectations is to provide our products through a variety of distribution channels, whether via the Internet, through a bank or building society, or a high street broker.'

Profitability

CGNU has grown much faster than its profits.

1. Page 18.

Table 35: CGNU's Financial Performance (£m, pence and %), 1996 to 2000

	1996	1997	1998	1999	2000	% Change 1996-2000
Pre-tax profits (£m)	589	568	771	808	-1,406	-138.7
Normalised earnings per share (pence)	44.0	38.2	18.4	13.1	-71.7	-63.0
Dividend per share (pence)	30.3	40.6	35.2	38.0	38.0	25.4
Market capitalisation (£m)	4,641	5,828	12,319	13,093	24,357	424.8

Source:Hemmington Scott/Key Note

The balance sheet includes more than £9.18bn-worth of property, which seems particularly big, because even Marks and Spencer (as one example) states the value of its properties as only £2.43bn.

There are two major reasons for the loss in 2000: £1.04bn on the disposal of its general insurance business in the US, and £448m on withdrawal from the London Market. However, after allowing for the fixed nature of these losses, it is evident that continuing activities were not markedly profitable. General insurance underwriting lost £1.89bn in 2000 and £879m in 1999, hence the company's keenness to offload its more disappointing general insurance subsidiaries. The operating profit from long-term business declined slightly, from £1.15bn in 1999 to £1.16bn in 2000. The strategy of going for mass-market low-margin products, such as stakeholder pensions, is unlikely to improve profitability in the short term, because in the main UK market there is little public enthusiasm for stakeholder pensions, so marketing will be an uphill struggle. The life insurance market is mature and growth will be difficult.

Like so many other banks and bancassurers, Norwich Union is looking to the wealthy as a profitable market sector. During 2001, the company is launching a wealth management service, described in the 2000 Annual Report as offering 'an integrated portfolio of competitive customer propositions', but it was not clear how the Norwich Union service would be more attractive than than similar 'propositions' from other companies.

CGNU has maintained dividends between 30 pence and 40 pence per share since 1996, and brokers expect the 2001 dividend to remain in this range. Brokers remain optimistic about the prospects for CGNU, but the question remains: is it trying to accomplish too much on too many fronts at once?

At present, Norwich Union's orphan assets, around £4bn, underpin its development plans for long-term savings. External borrowings totalled

£2.6bn at the end of 2000, and the ratio of external debt to shareholders' funds was 19%. To guard against a run on assets resulting from a single catastrophic event, the group has arranged reinsurance for more than £200m. Thus it is evident that the 'orphan', forgotten assets belonging to untraceable people, form a very buoyant life-raft for the company in difficult times. The £9bn-plus property portfolio also adds significantly to the comfort zone in the company's balance sheet.

Future Company Developments

CGNU is the UK's largest insurer and the sixth largest in the world, so future domestic expansion will be difficult without falling foul of anti-competition rules. The company is having discussions with the French group MMA/MAAF, about setting up a European partnership. CGNU already owns Abeille Vie in France, and has agreements with Bancaja in Spain, three large banks in Italy, and Wells Fargo in the US, among others. Partnerships are being sought with companies in India and China, for access to substantial potential markets for long-term savings, but when established these will take time to contribute earnings to the parent company. CGNU already has a powerful position in Poland, where it has 30% of the private pensions market and recruited more than 100,000 new customers in 2000.

The eastern expansion thrust of CGNU echoes HSBC's strategy of gaining business in Asia. Eastern markets are risky and potentially volatile. Growth on numerous fronts all over the world will be difficult to manage and evaluate. CGNU's eggs will be scattered amongst umpteen baskets, some of which will turn out to be basket cases. If only the British public could be persuaded to save and invest more, instead of relying on credit and property to meet their lifelong financial needs.

The bancassurance link with Royal Bank of Scotland in the UK — a dynamic bank rapidly gaining international experience — is likely to benefit CGNU even more than Royal Bank of Scotland.

PRUDENTIAL

Corporate Strategy

Worldwide, the Prudential manages more than £165bn, and in June 2000 obtained a listing on the New York Stock Exchange. In April 2001, the Prudential agreed to buy Allstate's majority holdings in Pt Asuransi Jiwa Allstate in Indonesia, and Allstate Life Insurance Co in the Philippines — consistent with a strategy of Asian expansion. However, a planned merger with US General Corporation of Houston did not go through.

In the UK, the Prudential is the leader in the annuities market, and benefits from legislation restricting the sale of annuities to insurance and bancassurance companies. This restriction means there is little need to market annuities heavily, because everyone with a personal pension is obliged to buy an annuity with their fund before they reach the age of 75.

However, dominance in a protected market has not been enough to drive the Prudential forward. In February 2001, the company announced 2,000 job cuts, and in May it dispensed with its direct sales force, many of whom are being taken on by Inter-Alliance Group of IFAs, so the Prudential staff are changing from tied sales to independent advice.

The company started a review of its £20m direct marketing budget in May 2001, after appointing TBWA/London to its £5m account for personal finance and personal insurance sales. Closer targeting is likely in future.

Advertising and Distribution

In some ways, the switch from direct sales to IFAs conveys a company which is taking one pace back from its customers to focus on fund management worldwide. Quite quietly, the Prudential has become a global brand, through Prudential Corporation Asia, Prudential Europe, and Jackson National Life in the US. Prudential was not among the big advertisers of financial products in the UK in 2000, rather as though it was taking a year to review its strategy.

The Prudential decided to launch a separate online bank, Egg, instead of using the Internet as an alternative distribution channel for its Prudential-branded products. The Egg brand has become widely known rapidly, helped by the short and rather odd name. It has been floated as a separate entity, although Prudential owns 79.53% (as at 17th July 2001). Egg lost £155m in 2000, a little more than the £150m it lost in 1999, and is a long way from generating substantial revenues for the company. Only around £247,000 was spent advertising Egg in the year to end June 2001, compared with nearly £8.1m for Abbey National's Cahoot.

Profitability

The past few years have not been happy for Prudential. Profits are harder to earn, but to keep shareholders happy the company has needed to raise dividends every year, when it may have been more sensible to cut them and invest in business development. At least the Prudential has stayed in the black, unlike CGNU.

Table 36: Prudential's Financial Performance (£m, pence and %), 1996-2000

	1996	1997	1998	1999	2000	% Change 1996-2000
Pre-tax profits (£m)	1,614	1,169	1,141	750	947	-41.3
Normalised earnings per share (pence)	31.6	31.5	32.4	26.5	25.9	-18.0
Dividend per share (pence)	17.3	19.1	21.0	23.0	24.5	41.6
Market capitalisation (£m)	9,455	14,232	17,684	23,838	21,340	125.7

Source:Hemmington Scott/Key Note

Less than 70% of profits now come from the UK, while almost 21% are from Asia, where the potential for growth in long-term insurance and retirement savings is enormous. Europe is still a minor business area, and a region with less potential for Prudential than the US, because the long-term savings market is mature, and European governments fund (for the present) pensions which are more generous than the UK's state pensions.

Future Company Developments

Prudential intends to become a major force in stakeholder pensions in the UK, but that whole market was knocked sideways in July 2001 when Equitable Life slashed the value of its funds by 16%, shaking public confidence in the whole concept of private pensions. On the whole, the Asian market looks more attractive than the UK for Prudential. The company's insurance sales in Asia grew 75% in 2000, to £504m, and life sales began in India and China. The China venture, in partnership with China International Trust and Investment Corporation, included opening a office in Guangzhou. The company has acquired Orico Life Insurance Co of Japan, and this gives the company a firm foothold in a very large life insurance market.

ABBEY NATIONAL

Corporate Strategy

Abbey National is flat out for growth. In May 2001, it agreed, through its subsidiary Cater Allen (acquired in 1997), to buy Fleming Premier Banking from J P Morgan Chase & Co for £106m. The purchase gives Abbey a 16% share of the UK's premier banking sector, which targets people with incomes exceeding £30,000 a year and liquid assets exceeding £50,000. The new business has £2.5bn of deposits between 126,000 account holders, an average of nearly £20,000 each. The market sector is rather quaintly called the 'mass affluent', who number about 3 million in the UK, to differentiate it from the really affluent, those with incomes of well over £100,000 a year. J P Morgan wanted to leave the mass affluent market in the UK — fears of a downturn, perhaps — but is retaining its private banking for the really rich. Abbey itself believes that another 2 million UK residents will be worth more than £50,000 by 2005, largely as a result of inheritances.

In its core mortgage market, Abbey is increasing market share and expects to account for more than 12% of home loans by 2003.

The bank's aggressive growth and self-promotion during 2001 is due to Lloyds TSB's unwanted £19bn takeover overtures, which have forced Abbey to react speedily. Early in July 2001, rumours surfaced that Abbey would consider bidding for Bank of Scotland, if the DTI rejected Lloyds TSB's takeover bid — as they did on 10th July 2001. Such a move was too late, though, because Bank of Scotland has already agreed to merge with the Halifax.

Advertising and Distribution

Immediately after hearing that Lloyds TSB would not be permitted to take it over, Abbey National embarked on a major rebranding campaign to modernise its image. The well-known 'couple under the umbrella' is to go, although it is instantly recognisable and symbolises Abbey National. One reason for moving on from the logo is Abbey's diversified business portfolio, and the similarly diversified distribution channels. The group includes First National, providing point-of-sale finance distributed through retailers, and finance to companies; Scottish Mutual (no longer mutual) with long-term insurance sold through IFAs; and the online bank Cahoot.

One interesting distribution approach is coffee-shop banking, which Abbey National has been experimenting with in 2001. Abbey National had 755 UK branches at the end of 2000, including those of the former National & Provincial Building Society, 25% down on the total in 1995, when the two organisations were separate. Abbey National has also joined forced with Safeway for supermarket banking — perhaps a risky move at first, because Safeway was losing market share, but now that the chain is performing much better, the partnership reflects well on both.

Profitability

Now that Lloyds TSB is not going to take over Abbey National, an easing of the share price is likely, at least until Abbey convinces shareholders that it knows exactly where it is heading. Pre-tax profits have increased steadily every year since 1996.

Table 37: Abbey National's Financial Performance (£m, pence and %), 1996-2000

	1996	1997	1998	1999	2000	% Change 1996-2000
Pre-tax profits (£m)	1,167	1,279	1,520	1,783	1,975	69.2
Normalised earnings per share (pence)	60.8	67.2	77.7	86.5	87.0	43.1
Dividend per share (pence)	26.1	30.7	35.3	40.3	45.5	74.3
Market capitalisation (£m)	10,765	15,412	18,242	13,632	17,452	62.1

Source:Hemmington Scott/Key Note

Future Company Developments

With any more expansion, the bank will soon have to start looking abroad for suitable targets and partners. The bank finalised the takeover of Scottish Provident Institution on 1st August 2001. As a consequence, another mutual has disappeared.

Abbey National still regards mortgages and savings as its core business, but intends to expand in life insurance and other long-term investments, in wealth management for the not-quite-really-rich, and in banking services to small and medium-sized businesses. By the end of 2002, around two-thirds of profits could be coming from outside the mortgages/savings core. The young are an important market, so Abbey National is launching new Internet sites geared to children, school leavers, students and graduates.

The company will remain on the lookout for acquisitions, which have cost nearly £3bn between 1998 and 2000. This is likely to mean expansion overseas.

LEGAL & GENERAL

Corporate Strategy

Legal & General's 2000 Annual Report portrays a company which takes a responsible view of risk, understands social policy objectives, and is creating partnerships as a foundation for future development. Standard & Poors gives Legal & General an AAA rating. Barclays has selected Legal & General life, pensions and investment products to sell throughout its network. Alliance & Leicester and Northern Rock have also selected Legal & General as an insurance and investment partner. The company's popular tracker funds have suffered in 2001 because their values have been dropping, so Legal & General will have to be innovative once again.

Advertising and Distribution

The group is refining advertising so that potential customers are told about products at times when they are most likely to purchase them — for example, when looking for a home at a Legal & General estate agency, or on searching online for a pension or ISA. There is less 'blanket' advertising and more emphasis on matching products with the people most likely to buy them.

Profitability

Legal & General's profits have moved in the wrong direction for 3 of the past 4 years. The reason for the decline in 2000 is a down-grading of longer-term investment returns, consistent with low inflation and low margins. The prospect of population decline over much of the developed world does not help, either.

Table 38: Legal & General's Financial Performance (£m, pence and %), 1996-2000

	1996	1997	1998	1999	2000	% Change 1996-2000
Pre-tax profits (£m)	1,937	610	406	676	498	-74.3
Normalised earnings per share (pence)	6.73	8.97	3.12	11.40	6.16	-8.5
Dividend per share (pence)	2.78	3.18	3.62	4.13	4.71	69.4
Market capitalisation (£m)	4,616	6,696	9,974	8,643	9,500	105.8

Source:Hemmington Scott/Key Note

Principal shareholders (as at 2nd July 2001) are the insurance companies AXA with 3.70% and CGNU with 3.06%. Brokers have very mixed views on the company's financial prospects. They expect pre-tax profits to be in the range £520m to £750m for 2001, and £580m to £715m for 2002. Prudential-Bache takes an optimistic view, thinking that profits in 2001 could reach £750m. Their forecast was on 20th March 2001, and could be downgraded following the damage to the whole long-term savings market resulting from Equitable Life's slashing of fund values by 16%. No one sees substantial profits expansion for Legal & General between 2001 and 2002, because of the near impossibility of generating a big domestic expansion in long-term savings and investments when the stock market is falling and potential customers are worried about the security of their money.

Future Company Developments

Legal & General believes it has the muscle and staying power to become a leading provider of stakeholder pensions as well as of ISAs. The company's tracker funds, which are simple to manage, enable customers to gain returns which are averaged out the relevant stock market indices. Trackers have been so successful in the UK that the company is considering launches in other countries, when stockmarkets are moving up again. Investors with tracker funds at the UK are moving out of them, or not commiting new funds, while the market falls. Acquisitions are not necessarily on the agenda, though. 'We do not and will not pursue a strategy of acquisition for acquisition's sake', said David Prosser, Chief Executive, in the 2000 Annual Report. The group has a strong board with international experience — and, unusually, a quarter of the board are women. Long-term, Legal & General has strong prospects, although 2001 to 2005 could be tricky because of difficulties in its crucial UK market.

ROYAL & SUN ALLIANCE

Corporate Strategy

Royal & Sun Alliance needs sharper edges, because its branding has been fuzzy since Royal Insurance merged with Sun Alliance in July 1996. The mantra on the cover of the 2000 Annual Report summarises the company's aim: 'building on our global strengths to set the agenda for the insurance industry'. This is a challenging objective which will need good fortune and no catastrophes, as well as business acumen, if it is to be achieved. Royal & Sun Alliance's business is 70% general insurance and 30% long-term insurance, with more than 20 million customers, offices in 50 countries and risks covered in more than 130 countries. At present, the company has no plans to expand in long-term insurance at the expense of general business, stating in the 2000 Annual Report that 'we are placing our growth emphasis on the general insurance business, where we are strongest and we believe that the returns are going to be greatest over the next few years'.

Advertising and Distribution

A £20m TV advertising campaign began in summer 2001, to promote a new brand identity for life assurance, savings and general insurance. Ogilvy & Mather and WWAV Rapp Collins devised the campaign, which needs to convey a brand identity very quickly, because Royal & Sun Alliance does not have money available to throw at promotion.

The company has achieved supermarket distribution, notably through ASDA and Sainsbury's. This partnership route is the way of the future.

Profitability

The advertising push comes at a time of difficulty: the company's pre-tax profits have fallen, from £378m in 1999 to £55m in 2000, and it sold off the direct insurer Swinton to MMA Insurance for £54m.

Table 39: Royal & Sun Alliance's Financial Performance (£m, pence and %), 1996-2000

	1996	1997	1998	1999	2000	% Change 1996-2000
Pre-tax profits (£m)	648	1,831	864	378	55	-91.5
Normalised earnings per share (pence)	26.6	18.4	-13.9	-39.9	-12.6	-47.4
Dividend per share (pence)	19.0	21.0	23.0	24.7	26.0	36.8
Market capitalisation (£m)	6,927	9,525	7,675	6,735	8,222	18.7

Source:Hemmington Scott/Key Note

The rapid decline in pre-tax profits from the peak in 1997 is creating great difficulties for the insurer, which brokers have mixed feelings about. Mostly they expect dividends to be maintained, and pre-tax profits to recover to 1998 levels. Prudential-Bache, which is one of the most pessimistic (or realistic) brokers as to results (pre-tax profits of around £700m in 2001, earnings per share of 29p), is one of the minority recommending investors to buy the shares, on the basis of long-term prospects. During the first quarter of 2001, losses continued — £306m, compared with a profit of £23m for the first 3 months of 2000.

The company's Annual Report is not among the clearest in the financial sector, but the recent downward trend is evident. Return on risk-based capital in general insurance averaged 5% in 2000, 5.7% in 1999, 6.1% in 1998 and 14.2% in 1997. The Finance Director, Julian Hance, stated:

> "The returns in 2000 and 1999 were below target, principally due to the poor underwriting conditions and exceptional claims events that prevailed throughout the period together with the impact of the investment market movements in 2000."

The likelihood of greater climatic instability in the years ahead, and with it, more severe weather events, would not help general insurance at all, because it would be harder to predict risks and thus set appropriate premiums. In any case, when premiums rise rapidly, customers do their own sums and often decide not to insure. Mr Hance commented in the Annual Report that 'in a number of operations the effect of inadequate pricing in prior years continued to have an influence'. It will not be easy for the company to raise premiums appreciably.

The principal shareholder, as at 29th June 2001, was fellow insurer CGNU with 3.07% of the equity. Shareholding otherwise is very widely dispersed, meaning that a takeover bid would be costly to organise because of the number of shareholders who would need to agree.

Future Company Developments

Greater global coverage is one major aim. As the 2000 Annual Report states:

> "Global businesses have an advantage because of their spread of risk. No single event will hit all of their operations. By contrast, single market businesses have to hold enough capital reserves to cover the worst loss that could happen in their particular country of operation."

This reasoning continues:

> "With the internationalisation of business, our commercial customers are increasingly seeking seamless coverage in all of the markets where they operate. Accordingly, we anticipate that the ability of an insurer to provide global coverage will be an ever more important competitive advantage."

Developing the company into a dynamic global general insurer will require management and strategic direction of the highest quality. At present, nine of the 12 directors are British, with the other three representing North America, and so it is worth asking whether the board includes sufficient experience from the rest of the world.

ALLIANCE & LEICESTER

Corporate Strategy

Alliance & Leicester, which remains a potential takeover target — perhaps for Abbey National — articulates its strategy as ‘understanding our customers and meeting their needs’. While every bank would have this as an aim, even if unstated, Alliance & Leicester aims to be the best at understanding customers.

It is achieving some big successes, for example, in online banking, which attracted over 2 million visits from personal customers in 2000. During the year, customers applied for more than 88,000 products online, more than two-and-a-half times more than in 1999. Personal loans and credit cards were most in demand, and for both, online applications accounted for around 10% of the total.[1] Online sales take Alliance & Leicester’s customer profile upmarket, because the AB’s are the keenest Internet users.

The Premier account, launched in November 2000, is an example of the ‘cross-selling’ product that Alliance & Leicester is very keen on. It offers a current account, savings account, credit card, travel insurance, and discounts on other Alliance & Leicester products. This is the key element — a venture to tie-in customers, reduce churn and thus cut the need to spend heavily on recruiting new customers. Alliance & Leicester is not among the big banks, and so customer retention is crucial to its future.

It has come up with a very good idea to recruit new customers — an account switching service, in which staff switch automated payments from the old account to the new one. The hassle of notifying the recipients of standing orders, and the originators of direct debits, is sufficiently great to deter most people from changing their current account, a big factor in the oddity that people are more likely to divorce than to change their bank. During 2000, the bank recruited over 500,000 new customers, a number which should be exceeded in 2001.

Advertising and Distribution

The bank has chosen to ally itself with the fun side of money for promotion purposes, viz through sponsoring the TV quiz *Who Wants to be a Millionaire?* The message conveyed is, save and invest with us and you too can become wealthy. Strategy is deeply influenced by the findings from staff focus groups — a technique which the Labour Party uses to good effect among the general public.

Distribution online, by telephone, post, and through branches of the Alliance & Leicester and Post Offices, is wide enough to be truly national, without the costs of a huge branch network: there are around 310 branches, 22% fewer than in 1995. For bancassurance, Alliance & Leicester links with Legal & General.

1. *‘Alliance & Leicester sets out stall as web bank’, MAD database, 15th February 2001.*

Alliance & Leicester ranks with much larger organisations for advertising spend. In the year to end March 2001, it put £4.7m into advertising its credit cards, according to ACNielsen MMS, more than the Halifax or the Royal Bank of Scotland. It was the second biggest advertiser of unsecured personal loans, with a spend of around £4m, behind Lombard Bank and Direct's £11.9m.

Profitability

The costs of investing in online banking, though, took the shine off Alliance & Leicester's profits in 2000. Pre-tax profits dipped by 9% to £447m, but still showed a 46% rise from 1996. Directors maintain that the 2000 dip is a price well worth paying for a strong position in online distribution. Restructuring costs are likely to depress profits until at least 2003.

Table 40: Alliance & Leicester's Financial Performance (£m, pence and %), 1996-2000

	1996	1997	1998	1999	2000	% Change 1996-2000
Pre-tax profits (£m)	306	395	455	494	447	46.1
Normalised earnings per share (pence)	45.1	52.6	58.7	63.3	66.6	47.7
Dividend per share since 1997 (pence)	*n.a.*	20.8	24.5	29.3	33.0	†58.7
Market capitalisation (£m)	*n.a.*	4,656	5,165	4,409	3,430	†-26.3

n.a. — not available

† — % change 1997-2000

Source:Hemmington Scott/ Key Note

Results for the first 6 months of 2001 show that profits are harder to obtain. Total income rose by £21m but pre-tax profits were £38m less than in the first half of 2000. Lower interest rates for loans and a cut in income from unsecured personal lending were important factors. On a positive note, mortgage business is rising.

The Prudential held 4.5% of the company (as at 27th June 2001) and is the largest single shareholder. Alliance & Leicester has had to work very hard at innovation and product development to retain shareholders' support, despite sound average performance between 1996 and 2000.

The board has international expertise which, at present, is under-utilised because Alliance & Leicester is a very British bank. This expertise could, however, prove to be a significant advantage if directors took a strategic decision to expand overseas.

Future Company Developments

An interesting new development, echoing Abbey National's coffee-shop banking, is Alliance & Leicester's 'movingimproving' initiative, a chain of finance shops which will advise on home improvements and sell finance for them. The first two shops opened in Banbury and Leamington in March 2001.[1] This development suggests a reconnection with the bank's building society past. Compared with the Halifax or the Barclays-absorbed Woolwich, Alliance & Leicester has gone for unsecured lending in a big way. 'movingimproving' hints at a return to the safer waters of mortgages and secured loans — for the present.

One problem Alliance & Leicester will have to solve is Consignia's termination of its agreement to accept cash deposits from the business customers of Alliance & Leicester's Girobank, but not from other banks. Consignia wants to offer this service to other banks too, to help compensate for the reduction in cash handling resulting from the payment of social security benefits directly into bank accounts.

NORTHERN ROCK

Corporate Strategy

The former building society, based in Newcastle-upon-Tyne, was the UK's fastest growing mortgage lender in 2000, adding almost 18% to its mortgage assets and taking them up to £18.6bn. The bank was the eighth largest mortgage lender, and overtook Bradford & Bingley during the year. Northern Rock is creating a successful niche for itself as a specialist in equity-release products for home-owners. This is a growth market because of the expanding numbers of over-60s, many of whom have bought a home but have not invested enough for an adequate private pension to supplement state and/or employers' provision.

Advertising and Distribution

Northern Rock is a distribution partner for Legal & General's investment products — an interesting combination, because both have a recent history of developing new products well suited to today's customers.

The bank advertised fixed-rate bonds strongly in the year to end March 2001, spending £580,000, according to ACNielsen MMS's calculations. It spent £223,000 advertising its equity-release products.

1. 'Alliance & Leicester launch home improvement offer', MAD database, 27th March 2000.

Northern Rock has amputated chunks of its branch network since 1995, when there were 156 offices. By the end of 2000, only 76 remained. The reduction fits with the bank's strategy of focusing on specialist product ranges, and dealing directly with customers.

Profitability

Northern Rock has established itself as a provider of competitive savings accounts and of innovative mortgages and related products, including equity release. Profits have improved every year since 1996. The market capitalisation value declined until 2000 but has recovered in 2001, to £2.54bn on 11th July 2001. The fall reflected investors' concerns about the bank's prospects as a relatively small independent ex-building society, as well as the general downturn in the popularity of banking stocks. The rise reflects the sentiment that Northern Rock is a relatively safe haven — and that it is one of the few remaining possible takeover targets.

Table 41: Northern Rock's Financial Performance (£m, pence and %), 1996-2000

	1996	1997	1998	1999	2000	% Change 1996-2000
Pre-tax profits (£m)	157	138	216	215	250	59.2
Normalised earnings per share (pence)	25.3	29.0	32.9	34.2	45.4	79.4
Dividend per share 1997-2000 (pence)	*n.a.*	7.0	12.0	13.6	15.5	†121.4
Market capitalisation 1997-2000 (£m)	*n.a.*	2,645	2,495	1,754	1,820	†-31.2

n.a. — not available

† — % change 1997-2000

Source:Hemmington Scott/Key Note

Results for the first half of 2001 were solid, with a 14% rise in pre-tax profits mainly due to a rise of more than a quarter in gross lending.

The leading shareholders (as at 12th July 2001) are Fidelity International with 5.22% and Prudential Corporation with 3.96%. Brokers expect continued but unspectacular growth in profits and dividends. Northern Rock is a solid performer, as its name suggests.

Future Company Developments

'More of the same' could sum up the bank's strategy for the future. High-volume low-risk lending, tracker funds and bonds for savers, and a continuing securitisation programme. The bank has made a cautious start to overseas expansion, starting with the Republic of Ireland and the Bahamas, and is certain to proceed carefully. The bank's success in combining cautious financial management with relevant new products is a good sign for the future.

The smaller organisations which follow in the short summaries below have been chosen to represent current trends in financial services: not-for-profit organisations; the former Post Office, now Consignia; National Savings; the Co-operative Bank; the Bradford and Bingley; and the latest mutual to float, Friends Provident.

NON-PROFIT ORGANISATIONS

The UK's leading medical insurer, the British United Provident Association (BUPA), is a charity. This enables it to hold fee levels slightly below fully commercial levels. The Nuffield Foundation, which offers private treatment plans and runs hospitals, is also a charity. The Nuffield Nursing Homes Trust, within the overall charity, runs 40 Nuffield Hospitals across Great Britain, in major cities and affluent towns like Tunbridge Wells, Cheltenham and Bournemouth. The trust expects 'self-pay' — non-insured — patients to fuel much future growth, and through Nuffield Direct offers fixed price packages so that patients know the full cost of their treatment before it starts.

The success of Nuffield Hospitals, in spite of the current plateau in private insurance contributions, owes much to custom from the non-insured public. The trust's charitable status means that it does not have to consider shareholders' profits, and can thus offer competitively priced treatments. The strength of Nuffield and of BUPA, and the advance of fixed-price treatments, mean that commercial insurers will have an increasingly hard job persuading customers of the merits of private medical insurance.

The charity Age Concern has a financial services division called Age Concern Financial Partnerships, offering products from companies including CGNU. Help the Aged also offers financial services, but such charity-commercial partnerships do not always offer competitive rates, especially for general insurance.

CONSIGNIA

The Post Office, renamed Consignia, is building more partnerships with banks and utilities, so that customers can use Post Office branches to withdraw and deposit money, as well as to pay bills. Customers of Alliance & Leicester, Barclays, the Co-operative Bank, and Lloyds TSB, can all use the Post Office as local bank branches. The Post Office sells National Savings, and so gives customers access to investments as well as to bank account services. There are around 18,400 Post Offices and sub Post Offices in the UK, 5.6% fewer than in 1995 — a much smaller reduction than in bank branches.

The Post Office's growing role in banking services is in part a response to its reducing participation in paying out state benefits, as the order book gives way to automatic payment into bank accounts. It is no longer possible for new parents, for example, to opt to receive child benefit at their Post Office, unless they are on income support. The national network of Post Office branches is ideal for customers to pay in and take out cash, and to make other routing transactions.

CO-OPERATIVE BANK

Co-operative Bank's parent, the Co-operative Group, is Britain's biggest farmer, biggest consumer-owned retailer, biggest funeral director, and biggest independent travel agent. The main purpose is to benefit the members through running a successful co-operative business. The Co-operative is an inclusive organisation: anyone can join.

Cash machines in co-op stores, allied to rapid development of Internet banking, have helped the bank to serve customers all over the UK.

The Co-operative Bank earned pre-tax profits of £96.8m in 2000 and in 2001 is likely to exceed £100m, up from £45.5m in 1996. The Internet bank smile, launched in October 1999, became the world's first Internet bank to gain the British Standards Institution kitemark, BS7799, for information security management.

Partnership between the bank and co-op stores continues to grow. Holders of the Co-op Cash Mini ISA, for example, can make deposits at the checkout. The bank has been busy cutting branch numbers, at the same time as extending banking services in co-op stores, and adopting online banking in a big way. There are around 90 bank branches, compared with almost 160 in 1995.

The Co-operative Group also owns Co-operative Insurance Services, which had a successful year in 2000, increasing new life, pensions and unit trust business by 6% to £303m, and non-life policies by over 45% to 505m.

All co-op businesses set ethical standards which they strive to meet. This is in tune with the current mood among the public for business activity which improves the environment rather than destroying it.

BRADFORD & BINGLEY

The Bradford and Bingley, which demutualised in 2000, ended the year with a slightly larger market capitalisation than Northern Rock, £1.89bn, although its pre-tax profits were much lower than Northern Rock's, at £159m. The new bank has launched 'Marketplace', providing independent financial advice for customers, and owns the mortgage broker John Charcol, which has a strong online presence. The bank is the UK's fifth largest estate agent, and so has a major role in the property market, which should be helpful in the present environment of stock market instability. The bank has around 220 branches, down from 246 in 1995. Brokers envisage pre-tax profits of around £260m in 2001, and steady but slower growth in 2002.

The strategy of offering independent advice is a strong selling point, but limits the bank's scope for exclusive partnerships.

FRIENDS PROVIDENT

The company's major strategy for 2001 was to float — accomplished on 9th July, with an initial value of £3.7bn. Eureko has a 5% stake, and Eureko's partners have another 5%. Friends Provident sells 80% of its financial products through IFAs, who are likely be pleased by Standard & Poor's uprating of the company from A to AA.

Profits on new business had been dipping southwards, a 25% drop in 2000 to just £63m, but the newly quoted company expects to improve profitability through growth. The company has ambitions to expand further in group pensions, in which it has a share of around 7%. The DTI's decision to prevent Lloyds TSB from taking over Abbey National will probably give Friends Provident a breather from takeover and merger overtures — but perhaps not for long.

NATIONAL SAVINGS

National Savings, the Government agency which takes deposits to help fund public-sector spending, is big: it has more than twice as many customers as any other retail financial services provider in the UK and looks after funds of more than £62bn. The organisation has an 11% share of non-risk personal savings in the UK. Around 30 million people have at least one National Savings product — and sales are buoyant, exceeding £10bn in 2000. Customers perceive National Savings as safe, at a time of uncertainty in the commercial sector. Products are available through the Post Office — around 18,400 branches — and by mail and telephone. In 2000, nearly two-thirds of the incoming £10bn came by telephone or post. Customers can apply for all products online, and this is increasingly popular.

Premium Bonds are still a big success story, gambling without losing the stake money. More than a quarter of a million people have the maximum holding of £20,000, and over 23 million have at least one bond. The £1m top award in the monthly draw was introduced in 1994, and proved a big spur to custom.

Debacles like Equitable Life's failure to protect all its customers will ensure continuing strong custom for National Savings, because of the absence of commercial risk.

12. The Future

WHAT ABOUT CUSTOMER CHOICE?

Financial services are a critical part of modern life, but customers have less and less choice of provider. They are becoming wise to the use of different brand names, and are increasingly aware that Direct Line is part of the Royal Bank of Scotland, as is NatWest; that HSBC owns First Direct; that Norwich Union is part of the CGNU conglomerate; and that Cornhill of past test cricket fame is owned by the German company Allianz.

The trend in each product sector is for four or five companies to dominate, with the others becoming niche specialists or being absorbed.

The largest of all, HSBC, does not seem particularly concerned about acquisitions in the UK, and is roaming the globe for strategic opportunities. Lloyds TSB's ambitions to take over Abbey National seemed odd, given the national doubt about emerging monopolies, and consumers' worries about adverse power balance between them and their suppliers. For both Lloyds TSB and Barclays, the big question is 'where next?' They need to expand their international operations because the UK market is now too concentrated.

HSBC is among the least concerned of the UK's banks with tying customers in, and in April 2001 proposed to launch portable bank accounts, which holders could carry from bank to bank with the absolute minimum of formalities. Lloyds TSB and Royal Bank of Scotland are in favour, but Barclays is opposed. Portable accounts, making it easier for dissatisfied customers to walk away, are also a positive aid to marketing if a high percentage of customers choose to stay with their bank: the fact can be trumpeted loudly.

In insurance, customer choice is just as constricted as in banking. Brokers find that often they cannot present customers with a range of quotes, because only one or two companies are willing to quote competitively for a particular risk.[1]

The major supermarkets, with the exception of Tesco and Sainsbury's, look to partnerships with existing banks rather than to creating their own. Tesco and Sainsbury's though, have done just that. Tesco Personal Finance is a joint venture with Royal Bank of Scotland, while Sainsbury's Bank is a venture with Bank of Scotland, shortly to be incorporated into HBOS. Sainsbury's Bank has changed its corporate identity in 2001, to link it more closely with the retail chain, conveying that it is an accessible supermarket-based bank.

Cost-cutting pressures combined with new technologies continue to lead to branch closures and more telephone and online banking, as well as supermarket banking.

At the start of the Internet revolution, there were hopes that new online banks would create competition for the traditional banks. This has not

1. Broker, Michael O'Shea of Caio Insurance, for example, often makes the point that the number of separate insurers is diminishing to such an extent that he has difficulty obtaining more than two quotes.

happened. The big banks and insurers offer online services as an additional distribution channel, because customers sometimes want to telephone (preferably not to an automated answering system), sometimes walk into a branch, and sometimes communicate online. The Internet-only companies cannot offer this diversity, and generally they lack trusted brand names. E-Prime Financial is a case in point. In July 2001, the former (dismissed) Chief Executive Gene Grant, holder of more than 10% of shares, applied for an extraordinary general meeting to consider winding up the company — a move opposed by the current board, which still has hopes of gaining a US Banking Charter. Such vehement infighting over winding up is symptomatic of the current state of online financial businesses.

LIMITS TO FOREIGN INCURSIONS

The strength of domestic financial services companies does mean that opportunities for foreign newcomers are now restricted.

Foreign companies have seized opportunities in two specific sectors: products for the over-50s and credit cards. The senior citizens market, for example, for guaranteed life insurance and equity release, has been opened up by Australian, American, French and German-owned companies. The Australian bank AMP owns the equity release specialist NPI, and GE Life, active in the same market, is US-owned. Sun Life, part of the French AXA group, and Cornhill, in the German Allianz group, have developed insurance products for older people as part of their overall insurance portfolios.

US companies have made headway in credit cards, because of the US's longer experience in and greater exploitation of rolling consumer credit. MBNA, Morgan Stanley Dean Witter and Capital One are prime examples, which have forced Barclaycard to lower interest rates and offer more benefits.

In other services, foreign representation is limited. The Bank of Ireland's Bristol & West is the 12th largest mortgage lender, and National Australia Group is the 16th largest, but otherwise mortgages in the UK are mainly a British business.

THE RICH, THE POOR, AND THOSE IN THE MIDDLE WHO PAY FOR BOTH

Life is not favouring middle earners and those with moderate savings which are above the thresholds for means-tested state benefits but not in the private banking league.

To reduce social exclusion, the Government has pressed banks to offer basic accounts and to work with the Post Office as the principal distribution channel. The outline plans to outlaw loan sharking and prohibit very high rates of interest, announced in late July 2001, are likely to impinge on the legitimate companies which offer home-collected credit and postal loans. At the other extreme, the huge demand to recruit the very rich into wealth management services means that fees have to be attractive — to the customers. Someone has to pay, and it is not the shareholders, but the middling wealthy. Lloyds TSB, for example, has recently increased the 'free banking' threshold on its Gold Service account from a £1,000 balance to £1,500, after repositioning the account downwards into the middle of its range. Let your balance dip below £1,500, and fees kick in. Barclaycard has announced additional fees for its credit-card holders, designed to sting those customers who do not repay their accounts in full, on time, every month, in the process revealing intentions which are exactly the reverse of the Government's credit-control proposals.

The increasing financial pressures on middle-income Britain may translate into a new demand for mutuals and co-operative organisations. Once that windfall has been spent, and customers see that companies' priorities are pleasing shareholders and getting along with the Government, there should be a reinvorated impetus behind mutuals. The Nationwide, the Chelsea and other surviving building societies all emphasise the advantages — for customers — of mutuality.

The banks are seizing on students as profit centres for the future, having theorised that if they show a helpful attitude during the years of hardship, graduates will feel goodwill towards them, and remain customers. Barclays is putting inserts in mailing from UCAS, the universities' central admissions service — quite a private-public partnership. Lloyds TSB is using direct mail focusing on the 'strength of brand, reputation and quality of service'.[1] HSBC is using direct mail, posters and telemarketing in an integrated campaign. The long-term results will be fascinating: how much 'churn' will there be? Gratitude is unlikely to overide financial advantage.

Old habits die hard. Claims Direct is a case in point. The company offers hope of compensation to people suffering injuries as a result of others' negligence, but has suffered from negative news reports about compensation payments being swallowed up by compulsory insurance premiums. Claims Direct tends to achieve results faster than the conventional litigation process, and offers redress to people on low and medium incomes, because legal aid is no longer payable for injury compensation cases. Yet, during 2001, clients are proving reluctant to entrust their legal claim to a large publicly quoted company — claim numbers have fallen from over 5,000 a month to under 2,000.[2] British conservatism is more active in the legal/financial sector than elsewhere in financial services, and this could slow the involvement of people with moderate incomes in a claims sector which otherwise has plenty of scope for growth. It is a double-edged sword for insurance companies — they could have more business selling public and professional liability insurance, but face greater payouts in successful negligence claims.

In the important personal pensions sector, the bombshell dropped by Equitable Life on 16th July 2001 is likely to have far-reaching repercussions. The troubled mutual slashed its with-profits funds by 16% — so around a million people saw their life and pension funds tumble as though there had been a stock market disaster. This serious example of dashed expectations is likely to cut public interest in stakeholder pensions, which the Government so much wants the majority of adults to save for. The Government now needs to

1. 'Big four gear up for attack on student banking sector' by Glen Mutel, MAD, 4th May 2001.
2. Claims Direct was told in July 2001 that it would be investigated by the DTI, but this does not alter the fact that ventures like this can be of great help to injured persons with modest incomes.

rethink. Why should people struggle to invest in a pension fund which can decline in value if the company gets into difficulties? If Tom Brown saves the same amount as Ben Smith, but his pension is only half as much, Mr Brown may feel that he is living in an inequitable society. Some form of state guarantee is required, to underpin savings for personal pensions.

The problem of middle-income investors became very apparent in summer 2001, when companies began to apply market value adjusters (MVAs) to try and prevent investors taking out their money. For ‘adjuster’ read ‘reduction’. Norwich Union imposed a discretionary MVA of 3%, and newly-floated Friends Provident applied one of 5%. The penalties will cause investors to think long and hard: do they leave their deposits where they are, in the hope that the stockmarket will revive, and bonuses with it, or do they accept the penalty, withdraw their cash and look for a safer home for it? Middling investors, without a portfolio manager, and unable to afford IFAs’ fees of around £100 an hour, need to calculate the risks themselves.

The worldwide stockmarket fall of 2000 and 2001 casts doubt on the wisdom of promoting personal pensions and endowment insurance for the mass market. The world is far too uncertain. Scottish Life, for example, assumes annual fund growth of 7%, an annuity rate of 6%, and inflation in national average earnings of 4%, when suggesting that a man aged 35, aiming for a pension of half national average earnings, needs to put £639 a month into a pension plan. This is £7,668 a year, and clearly far beyond the means of most working adults. The main point, though, is that annual growth of 7% looks very high from today’s vantage point. Annuity rates of 6% seem optimistic, too, because many suppliers are paying less than 6% on escalating annuities.

What are insurers to do? Premiums for general insurance, such as contents and buildings, are becoming a problem for lower-income households. Long-term with-profits insurance and personal pensions are proving too risky. One possible solution is for companies and Government to work in partnership so that a minimum level of return is guaranteed.

The concept of the ‘protected fund’ is an improvement for investors in that the initial capital is guaranteed, but if the fund grows, the investor does not receive all the growth. Barclays Capital Securities manage six protected ISA funds: JP Morgan Fleming Premier Equity Growth, ABN Amro UK Growth, Gartmore European Selected Opportunities, INVESCO Perpetual European Growth, Framlington Health, and Aberdeen Technology. At present, the amounts held in these funds are strictly limited.

As for stakeholder pensions, they are not appealing to lower income-earners, as the Government intended, but to affluent parents taking them out for their children — a tax-efficient way of avoiding inheritance tax — and to the already retired, but under 75, who can buy a stakeholder pension and immediately cash it in for an annuity. Think again, Mr Brown.

WHERE DO INDEPENDENT FINANCIAL ADVISERS FIT IN?

Independence is a relative concept. Major financial services companies continue to buy up independent financial advisers (IFAs), and although the staff are in theory free to recommend products from the entire market, they also have an obligation — even if unstated — to their employer.

Even the largest firms of IFAs are finding that partnerships are necessary, to give them the necessary scale to compete with the corporate firms. Inter-Alliance, with more than 1,300 advisers, linked with online financial service Moneynet in April 2001 in an exclusive partnership which introduces Inter-Alliance advisers to Moneynet users.

Competition for the best IFA firms is strong. In July 2001, the Bank of Ireland's subsidiary Bristol & West purchased — subject to regulatory approval — the IFA Willis National from Willis Group and Abbey National, for £40m. Willis National, specialists in pensions and corporate finance, has 300 staff and 18 offices in the UK. During 2000, Bristol & West had already extended its advisory interests with the purchases of MoneyeXtra, an online financial information service, and Chase de Vere.

Abbey National's willingness to part with its share of Willis shows that its priorities appear to be promoting its own products, not advising on other people's. This promotional push is sometimes leading it into trouble — the Advertising Standards Authority, for example, in May 2001 upheld a complaint that Abbey's advertising for free overdrafts and free banking was misleading.

ETHICS FOR THE 21ST CENTURY

To what extent will financial imperatives continue to dominate banking in the 21st century? This appears a silly question, for surely banking must, first and foremost, be about finance?

Yet as the Co-operative Bank shows, objectives of serving customers — as individuals and members of sustainable communities — are assuming greater significance now than at any time since the Second World War. The Co-operative Bank, and mutuals such as Liverpool Victoria, should benefit substantially from their ability to plan for the long term because they do not have shareholders' immediate needs to consider. Liverpool Victoria, the largest friendly society in the UK with assets of over £5.5bn, and top of the endowment performance league in 2001, took over the Royal National Pension Fund for Nurses in July 2001, after selection by the Royal National, which wanted to develop new products but lacked the scale to do so.

Global companies which are so big that they do not clearly hear customers' local concerns face problems of potentially adverse media coverage. Banks which invest in environmentally dubious projects, such as oil drilling in Alaska, or tree clearance in the Amazon basin, will face more critical public scrutiny. The ethical indices, FTSE4Good, launched in London in July 2001 are a significant move, because they reflect public worries about investments which could harm people or the environment. Of course, there are arguments about the companies which have been included or left out of the indices, and criticisms that the indices are just window-dressing, but they do represent a changing public mood.

Friends of the Earth lost no time in criticising the list of companies included. NatWest (Royal Bank of Scotland) and Barclays have both financed deforestation in Indonesia, and Sainsbury's has encouraged the use of pesticides, says the charity.[1] Provided that inclusion in the indices is kept under critical review, it should improve the public's knowledge about companies' impact on the wider world. Financial services companies which invest in ethically dubious ventures will find themselves under greater scrutiny than hitherto. This scrutiny would become a powerful commercial dynamic.

Companies will no doubt try to fudge the issues, as HSBC does in its 2000 Annual Report (p20), where it explains:

> "... with operations in 79 countries and territories where different cultural and political systems apply, we have to strike a balance on environmental issues. This does not allow us to report our monitoring and performance results easily since there can be no blanket standard of measurement that can be applied to the Group."

That degree of relativism will not be sufficient in the years ahead.

WHO HAS THE BEST CHANCES?

The forces shaping financial services in the UK include political opposition to further concentration and the ageing demographic profile which is increasing demand for pension extenders and other products aimed at the over-50s.

Pension extenders rather than pensions: personal pensions linked to the stock market are too risky for the mass market, unless they are underpinned by a state guarantee. Stakeholder pensions for the unpensioned look like dying in the water.

Today's middle-class middle-aged are receiving larger inheritances than ever before from their parents' generation, thanks to the great post-war rise in owner-occupation. These inheritances augment pensions and reinforce the British dedication to property as a very solid form of wealth.

Northern Rock, a former building society, is creating a niche for itself as an important provider of equity-release products, positioning itself firmly as a mortgage and savings bank which caters well for the needs of its older customers, and has bright prospects in the coming decade.

The early UK entrants in the 'senior citizens' market were mainly foreign: NPI, owned by AMP of Australia; GE Life, part of General Electric of the US; Sun Life, part of the French AXA group; and Cornhill, part of Allianz of Germany. It is surprising that these companies were so much quicker than most domestic companies to see a market opportunity.

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1. 'FTSE's new ethical stock indices have come under fire from unions, environmentalists', Hemscott, 10th July 2001.

Bradford & Bingley has stayed true to its building-society origins, with estate agency and independent financial advice, and is constructing a distinct niche as Northern Rock has done. The British obsession with property is important for both. Co-operative Bank has a strong niche too, in ethical banking.

The present Government's reluctance to allow mega mergers or takeovers means that the big banks will have to look for expansion opportunities overseas. The Halifax and Bank of Scotland merger to form HBOS is probably the largest that UK financial services will see for a year or two, and they will form a solid bank, powerful in the mortgage market. It is just a pity about its name.

Barclays has to diversify profitably overseas, and its plans to link with a Canadian bank for a joint venture in the Caribbean show that it is only too well aware of the need. HSBC's focus is shifting eastwards to China and the Pacific, where some ventures carry sizeable risks, but at present the bank should be able to absorb them. The Prudential, too, is expanding in the Orient, with large ventures in China — potentially a huge market — and in Japan. Royal Bank of Scotland is growing in the US, and has good prospects provided that expansion does not force it to increase its capital base too fast. The bank's decision, in summer 2001, to raise £2bn for the acquisition, through its Citizens Financial subsidiary, of the Pennsylvania, New Jersey and Delaware regional franchise of Mellon Financial Corporation, was warmly greeted by analysts, and the share price continued its heady upswing. The Melon business includes $6.1bn in loans, of which almost 30% is in student loans guaranteed by the Federal Government. However, given the uncertain outlook for the US economy, the $75m provision for defaults — equivalent to 1.5% of the non-guaranteed loan book — may be too low.

Rapid business expansion in a time of global volatility — economically and environmentally — carries greater risks than directors, shareholders and analysts have so far been ready to admit, at least in public.

13. Glossary

A, B, C1, C2, D, E — The socio-economic group classification in common use in the UK. The As are higher professionals, Bs are lower professionals, C1s are skilled non-manual workers, C2s are skilled manual workers, Ds are semi-skilled and Es are the unemployed, retired on state pensions, and others at the lowest income levels. The NOP interviews have to allocate them to a category, and this is far from an exact science.

APR — Annual percentage rate of charge.

ATM — Automated teller machine.

Call centre — A work environment in which the main business is conducted by telephone while simultaneously using display-screen equipment (DSE).

Dividend cover — Earnings per share divided by dividend per share.

DSS — Department of Social Security.

DTI — Department of Trade and Industry.

FTSE — *Financial Times* Stock Exchange index.

GDP — Gross domestic product.

Gearing — Ratio calculated by dividing loans to the business by the shareholders' equity. The higher the ratio, the greater the business's dependence on borrowings.

ICT — Information and communications technology.

IFA — Independent financial adviser.

ISA — Individual Savings Account. There are three types — cash, stocks and shares, and insurance, all with different conditions, and in two levels, mini and maxi. The maximum investment in ISAs in 2001/2002 is £7,000.

ACNielsen MMS primary financial categories — 1999: generic corporate, cash machines/ATMs, credit/charge cards, current accounts, deposit accounts, financial services, insurance corporate, insurance health, insurance house/contents, insurance general, insurance life, insurance motor, insurance travel, insurance other, investment bonds, investment trusts, ISAs, loans, mortgages, offshore banking, pensions, PEPs, savings/investments, stockbrokers/share dealing, TESSAs, unit trusts.

2000: asset management, bonds, business banking services, business finance and loans, company notices, current accounts, corporate finance, general banking services, general investment schemes, insurance, insurance life, interest-rate announcements, ISAs, monthly plans, mortgages and related products, other financial services, pensions, PEPs, personal loans, plastic cards, savings accounts, sponsorship, unit and other trusts.

NOP — NOP Solutions, a market research organisation which carries out surveys for Key Note.

Normalised earnings per share —These are FRS3 earnings per share modifed to exclude extraordinary items, and adjusted for share capital changes and annualisation. FRS3 refers to the reporting standard introduced in 1993, which requires companies to calculate earnings per share including all extraordinary items.

Orphan Assets — Orphan assets are funds which arise from deposits by people who have never claimed them because of death, or because the company cannot locate depositors who have forgotten about their assets.

PEP — Personal Equity Plan: stockmarket-linked investments sheltered from tax. They have been replaced by stocks-and-shares ISAs, but existing PEPs can be retained.

RPI — Retail Price Index, the usual measure of price inflation.

SAYE — Save As You Earn: savings deducted from employees' wages and salaries.

SERPS — State Earnings-Related Pension Scheme.

SOC — Standard Occupational Classification.

TESSA — Tax-Exempt Special Savings Accounts, now closed to new savers. These have been replaced by Individual Savings Accounts (ISAs). When TESSAs mature, the capital can be reinvested in Tessa Only ISAs (TOISAs).

TOISA — Tessa Only ISA, see TESSA.

WAP — Wireless Application Protocol, enabling mobile phones to access the Internet.

14. Further Sources

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Association of British Insurers
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http://www.bba.org.uk

Building Societies Association
3 Savile Row
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Fax:020-7734 6416
http://www.bsa.org.uk

Consumer Association
2 Marylebone Road
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Fax:020-7770 7220
http://www.which.net

Direct Mail Information Service
5 Carlisle Street
London, W1V 6JX
Telephone:020-7494 0483
Fax:020-7494 0455
http://www.dmis.co.uk

Direct Marketing Association (UK)
Haymarket House
1 Oxendon Street
London, SW1Y 4EE
Telephone:020-7321 2525
Fax:020-7321 2525
http://www.dma.org.uk

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Campaign (weekly)
Haymarket Business Publications
174 Hammersmith Road
London, W6 7JP
Telephone:020-8267 46683
Fax:020-8267 4915
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Daily Telegraph
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Canary Wharf
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City Innovation Centre
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Centaur Communications
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Bonnier Information Sources

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http://www.pru.co.uk

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http://www.royal-and-sunalliance.com

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http://www.royalbankscot.co.uk

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http://www.sainsburysbank.co.uk

Scottish Widows
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Edinburgh, EH3 8YE
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Standard Life House
30 Lothian Road,
Edinburgh EH1 2DH
Telephone:0131-225 2552
http://www.standardlife.co.uk

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Field research is commissioned for various consumer reports and market reviews, and is carried out by either BMRB International (BMRB Access) or NOP Solutions (National Opinion Polls).

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Key Note Publishing Manager, 2001

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Breweries & The Beer Market	20	2001
Bricks & Tiles	12	1999
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Bus & Coach Operators	5	2000
C		
Cable & Satellite TV	8	2000
Cameras & Camcorders	3	1999
Camping & Caravanning	12	2000
Canned Foods	12	2000
Carpets & Floorcoverings	14	2000
Cash & Carry Outlets	15	2000
Catering Equipment	5	2000
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Childcare	2	1999
Childrenswear	3	2000
Chilled Foods	10	2000
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Clothing Manufacturing	12	2000
Clothing Retailing	3	2000
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Commercial TV	6	1999
Commercial Vehicles	10	1999
Computer Hardware	3	1999
Computer Services	5	1999
Computer Software	4	2001
Confectionery	20	2001
Consumer Internet Usage	4	2000
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Contract Cleaning	16	2001
Convenience Retailing	11	2001
Corporate Hospitality	2	2000
Cosmetics & Fragrances	14	2000
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Courier & Express Services	11	2000
Credit & Other Finance Cards	12	1999
D		
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Debt Management (Commercial & Consumer)	1	2001
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Glassware	10	1999
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H		
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R		
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