Editorial: Key trends in retail banking

The trends currently shaping financial services markets are truly unprecedented and universal inasmuch as their effects have been felt throughout the world. These trends have caused more change over the past two decades than in the two previous centuries of banking history combined. In this editorial, I would like to identify and discuss the nature and implications of these trends for research in retail banking.

The trend towards deregulation heralded the abolition of cartelised oligopolies and restrictive practices and exposed financial markets to the cold wind of increased competition by undermining the traditional demarcation lines that once separated different types of financial institution into discrete markets. As a consequence, new entrants with different and, in many instances, lower cost structures are coming into the financial services markets and actively competing against the traditional players.

In addition to the increased level of competition, the very nature of competition has also changed. Although it is perhaps unrealistic to divide history into separate time periods, it is, nevertheless, helpful to illustrate how competition has changed over recent years: the 1960s were typified by functional competition with commensurate emphasis placed on large branch networks and service quality; the 1970s saw these branch networks rationalised to some extent and banks and financial institutions competed increasingly by becoming product orientated. As a consequence, new products could, and were, replicated by competitors, so that by the end of the decade it was the norm for commercial banks to offer hundreds of services via their branch networks. In the 1980s, product innovation continued, but

banks also became increasingly market orientated as they started to segment the 'universal' market and ascertain which products were best suited to particular customer groupings. In the 1990s, banks continued to be product innovative and market orientated, but they also emerged as strategic organisations as they strove to determine which markets they wanted to be in and what their market position should be in these chosen markets. Strategic orientation also has far-reaching implications for managerial structures, organisational culture, recruitment and training, and a wide range of other important considerations.

Technological advances meant that computers moved from back office to front office and then developed, from being simply a means of processing cheques and money transmissions, into distribution channels in their own right. Consequently, financial institutions no longer think exclusively in terms of branch network, but increasingly in terms of a mix of delivery channels. Arriving at the 'optimum' mix of channels and determining how this optimum should vary between different customer groupings constitute just two potentially important questions facing banks.

Advances in technology-driven distribution channels and the commensurate decline in the importance of branch networks have eroded the substantial entry barriers into the banks' traditional markets while simultaneously increasing the exit barriers for the banks themselves. Exit barriers, when measured in terms of the costs associated with domestic branch closures and staff redundancies, in addition to the harmful effect this action has on the public's

perception of banks, are extremely high and banks are faced with a dilemma in deciding whether to adopt a gradual or a radical approach to closures.

Banks are also rapidly emerging as strategic organisations. These strategies are partly in response to the changes taking place within financial services markets, but they can also be regarded as independent evolutionary processes in their own right indicating that banking organisations are no longer passive bystanders, but that they actively pursue proactive policies in the marketplace. These strategies have meant increased emphasis on product development, asset growth, customer service, diversification, relationship banking, customer retention, database marketing, etc.

The arrival of new entrants into bank markets has increased pressures on bank profit margins, especially as these new entrants are effectively 'cherry picking' and only choose those products and markets that offer the highest profits. To this extent a bank's ability to cross-subsidise other parts of its business will be reduced, thereby increasing the need not only to achieve further internal economies, but also to raise prices and possibly reintroduce pricing for services and products that are currently offered 'free of charge'. How this

can best be done without further damaging the public image of banks will constitute another important research issue.

The final important trend in retail banking relates to excess capacity, ie too many players competing for a finite volume of business. As a consequence, banks are experiencing decreasing returns to scale which suggests that additional investment within their traditional core banking activities will reduce profitability. Diversification into ancillary business and merging with other financial institutions to benefit from economies of scale seem to be the most obvious ways of increasing profitability. Therein might be found the single most important force determining the future structure of the financial services industry, as large financial conglomerates develop with the intention of offering comprehensive packages of services. At the other extreme, however, it would seem reasonable to suggest that there will always be room for small financial institutions focusing upon a particular market niche or segment. Further research into the economies of scope and scale would, therefore, appear to be a necessary and sensible way forward.

BARRY HOWCROFT
Guest Editor