THE FUTURE OF BANKING INSTITUTIONS

A CONTRIBUTION TO THE DISCUSSION

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In a modern economy banking plays an indispensable role. Commercial banking institutions as the main institutions of the banking sector must continually adapt their operations to changes in the environment. In so doing there arises the question "Is the current form of banks also their future form?" or " In what form will banks operate in the future"

Traditional banking institutions have long been exposed to strong external pressures. These pressures have been brought about by the influence of worldwide globalisation and unceasing technological development. Their result is growing competition, a tougher battle for the favour of new customers and maintaining that of existing customers, for lowering costs, increasing productivity and efficiency. Will banks be able to maintain their high standing in the market of financial services providers, or will they gradually lose it under the influence of these pressures? We take a closer look at this issue.

It is not only capital, but mainly information which represents the basic elements of success in banking. Quality information can even represent the main source of competitive advantage. Information on the market, clients, their needs and habits, on the competition, financial resources and areas of their greatest appreciation, and all this not only in the part of data that help banks to foretell their competitors in the field of providing financial services. Gaining such information was in the past a much more demanding task. It is the development of information technologies that has caused access to information to have been significantly simplified and facilitated. This phenomenon however has paradoxically brought banks more difficulties than use.

Financial intermediaries have always exploited that which others do not know or have not until then known. Therefore investors with spare funds, as well as clients with a need to borrow capital have always turned to them with confidence. Clients with spare capital have believed that financial intermediaries have the best information on the best appreciation of their money and on the other side of the coin; subjects with a need for financial resources have assumed that intermediaries know of the best sources of free capital. It is necessary to say that in the majority of cases this has been true.

With the development of information technology however this advantage is slowly escaping financial intermediaries. With the development of the internet the possibility is growing for subjects to gain information with little effort and low costs which before had been known only to banks and similar institutions.

The USA, which has long led trends in the global economy, the share of bank loans in the total volume of loans to natural and artificial legal entities has declined from 36% in 1974 to 22% in 1994. This phenomenon has been caused by among others a boom in alternative sources of business financing. The share of commercial securities issued, in comparison to loans to business subjects in the USA represented 5% in 1970. In 1994 however this figure had already grown to 20% and this trend continues to date. (See source materials, A)

Banks have been forced to react to this change in the business environment through various defensive strategies. In the framework of large chains they have begun to combine together, connecting their activities with other branches of the financial market (for example with the insurance industry, pension funds, fund management companies), thereby strengthening their capital position. Banks recently have been swept by numerous trends, causing marked changes in their position and operations. The main changes have been:

• The combination of banking institutions[1].

• Internal management information systems allowing a high level of control in management, also at a greater distance thus enabling banks to grow in terms of size, geographical coverage, and the number of services provided.

• Simple verification and accounting has been made possible through a boom in operations made via payment cards.

• The simple electronic transfer of funds has led to huge growth in the amount of financial transfers between individual institutions and financial centres.

• Fully automated "client centres" have enabled banks to reduce the number of their classical branches and subbranches. The administration of these centres involves sig-

[1] Already today in OECD contries 40% of all financial assets are controlled by the 100 largest world financial institutions.

nificantly lower costs than the maintenance of branches and sub-branches.

• A significant growth in financial activities via the internet.

These changes have caused banks to become larger, better, faster, more reliable and resistant. This is not however the full story. Even if banks have become larger, whether in terms of size or capital, the effect of technological changes has at the same time significantly weakened them.

We have already mentioned the example of the decline in market share with traditional bank businesses. Banks have reacted to this decline through increasing the other types of business activities. The share of revenues from fees in comparison to that of interest revenues has significantly increased in the framework of a bank's total income.

Even despite all these efforts banks have however lost their position of eminence in the market for providing financial services[2]. The traditional business models of the existing "big players" are constantly being confronted by smaller players in the market using technological innovation much more flexibly for competitive advantage.

The main factors of influence representing the greatest potential danger for existing banks are in particular:

• A multitude of new highly specialised firms arising, representing competition to traditional banking activities,

• Further development of the internet and information technologies

• A new generation of money

• Pressure for lowering costs and a change in organisational structure.

The new era for competition among banking institutions

Banks devote themselves to a lesser extent to research activity in the field of technology, and the majority of changes have come into banks from banks from other sectors of the economy. Banks also represent a complicated structure of relationships and processes, which does not enable them to react flexibly to a changing environment and customer sentiment. The great extent of various activities and the complicated structure mentioned do not allow banks to offer in every sphere and field the best product for the best price. Rather, banks profit from providing comprehensive services, their large capital, experience and reputation.

As a consequence of all these aspects a multitude of small, flexible and highly specialised firms are arising, and which are managing to compete with banks in specific spheres precisely on the basis of their own ability to better adapt to the customer and satisfy their need for a better price.

The significance of technological developments

High speed telephone links, high performance computers, perfect data encryption, third generation mobile communications, the internet and ever more intelligent software, this is only a shred of the new technologies which have swept across not only the banking sector, but many others. It is mainly the internet and the technologies connected with it that are having a great effect on banks. On the one hand they enable 24-hour interactive communication between the bank and its clients, but on the other hand however, raise competition and develop pressure for efficiency and a lowering of costs. The internet brings lower prices, interest rates and fees and an improvement in conditions for the customer. Today there now exist in the world various interactive auctions and search systems, which locate products in the cybernetic world with the lowest prices and the best conditions. The popularity and abilities of various systems is constantly increasing. The future belongs to ever more sophisticated systems that will no longer provide "merely" information to their owner, but could also make decisions for them on a real-time basis. On the basis of defined criteria on their living style and needs, expected yields and attitude to risk they could automatically distribute and administer the owner's personal assets. Following consideration of all conditions they could automatically on a real-time basis shift the owner's resources to that place with the most appropriate rate of appreciation.

A new generation of money

One of the most radical changes expected is that in the essence of money itself. It is not only commercial banks, but also the monetary authorities of states that must wrestle with this change. The development of technology brings with itself new types of money electronic, digital, and cybernetic. Already today the trend is noticeable of a move away from paper money to money in the form of data. With the development of wireless communications there are already arising so-called intelligent cards, which enable an encrypted row of digital streams to be received and sent remotely. There will no longer be necessary the contact of a payment card with an EFT POS terminal, or ATM. It will simply be enough to from a remote point confirm and settle the payment in question. Although this does not mean that through this process cash money will soon become redundant, it does mean that the intensity of its use will be set on a gradually decreasing course.

The development of information technology is also bringing room for mutual clearing between various markets subjects without the use of banks as intermediaries. Trades

[2]. Among the main competitors to banks are: fund managemet companies, insurance companies, investment companies, stock brokers, specialised companies operating in fields that have traditionally been banking services, in particular trough the use of new technologies.

settled in this way need not be caught in an official clearance systems and represent a risk not only for commercial banks but also for monetary authorities in the form of national banks trying to influence and manage the monetary base in a state.

A problem in connection to this could also be specialised so-called electronic money, the use of which will be conditional, for example, upon its specific location, items, and institutions. Various institutions already today are using their own money. Mostly they are intended for a closed community, the possibility of their boom however is not excluded. Their values may be tied for example to the price of minerals, the values of official currencies. The use of such "clearing funds" will also represent a problem also for monetary management.

The pressure for lowering costs and raising efficiency

In connection with the need to catch hold of changes in the environment and to face down the pressure for lowering costs, it will be essential for banking institutions to change and adapt their model of doing business and their organisational structure. In the past customers as well as banking employees have had to come physically for specific information. This process however is now shifting to precisely the opposite location. Banking institutions today it is much cheaper to send individual information and not physical people. Banks should gradually change into virtual organisations, which represent specialised interactive networks for the exchange of information. Their complete work places (other than registered offices) need no longer be located in the most expensive areas in large towns, but will shift to localities with lower expenses rent and workforce. Also the number and operations of branches and sub-branches should decrease. More use should be made of fully automatic service centres and alternative ways of accessing customers[3]. In connection with this there is also a trend towards a reduction in the number of employees. Of course, there are areas in which personal contact with the customer is irreplaceable. This concerns mainly consultancy and highly sophisticated services. In other fields however personal contact will recede ever further into the background.

Banks should identify those activities that could more effectively be performed for it by an independent firm and so exploit the great advantages of outsourcing[4]. In the world this trend is already at present used to great effect and unarguably its use will only increase in the future.

[3]For example, the internet, call centre, home banking, GSM banking.

[4] We can briefly characterise outsourcing as the detaching of ancillary activities, these activities then being performed in the framework of a separate company, in which the company has complete or partial representation.

How can banks maintain or expand the range of their operation?

It is a fact that already today in the world there operate many non-banking institutions in traditional banking spheres. They are in many cases more flexible, more adaptable, more innovative and usually also less regulated. The low expenses for telecommunications services and computer technology enables them to operate globally and address a huge number of customers, many times more successfully than banks themselves.

In this situation banks should identify precisely the needs of their customers and adapt as best as possible to these. They should utilise the strength of technology in their favour and create an interactive relationship with customers, with the help of which they will provide them with a complete framework of financial services. They should create a platform which integrates information, communication and the appropriate financial services. In their activity they should focus on the performance of the main active and passive banking operations. Other services should rather be left to specialised companies which manage to provide them much more efficiently. Banks can create subsidiaries or in the framework of cooperation, work with external firms. Banking institutions should gather these together under one roof, connect them in the framework of a single whole and to provide them with a well-known brand, guaranteeing quality and possibly control as well as managing their risk. In this way the customer in the framework of one package could get a comprehensive set of financial services of the best quality and for the most attractive prices.

Banks of the future should in short be integrators of financial services searching for and knowing the specific needs of the customer.

Today's period of globalisation and burgeoning technological development brings for banks innumerable opportunities. It is necessary however to take into consideration the fact that the customer has a multitude of such opportunities. However, for banks that manage to exploit this situation today there undoubtedly await a huge number of possibilities tomorrow. However, for those unable to adapt, there awaits probably an uncertain future.

Source materials:

1. NOAM, E. M.: Electronics and the Dim Future of Banks, Contribution at the conference on electronic banking, Fujitsu Research Institute, 1996

2. Saxena, A., Grandhy, N.: The Future of Financial Institutions. www.columbia.edu

3. Contributions from the conference Management for the Third Millennium, Institute for International Research, 1999.