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CORE COMPETENCIES IN THE RETAIL SECTOR OF THE FINANCIAL SERVICES INDUSTRY

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ABSTRACT

The combination of these rapid structural changes has forced retail service providers to develop new managerial capabilities and technical competencies. Financial service providers must be sure to differentiate their managerial capabilities: service (customer interface), intellectual capital and infrastructure management. Instead of focusing on end-users (customers) a firm may change its strategy to develop economies of scale in transaction execution. This allows new entrants to become aggregators and interface with the customer. At is point the firm has become a commoditized service provider, furthest from the points of sale. The transaction execution component is the domain of Sales, IT and Operations. The transaction component accepts the inputs from the customer interface and processes the data. Once the processing is competed, the results are forwarded to the customer through an appropriate interface. The skill sets of the transaction and customer interface converge on data processing, CRM-data mining and systems integration. This skill set is especially important for customized products.

KEYWORDS: *e-Business Platform, franchise, ROI, Disintermediation.*

INTRODUCTION

In the Market, these factors have significantly changed the “rules of the game” for providers of financial services. The combination of these rapid structural changes has forced retail service providers to develop new managerial capabilities and technical competencies.

For each market segment there is a set of core competencies that is required to successfully compete in that market space. The value proposition that a firm offers lies in its ability to differentiate from the competition. This differentiation must occur within the following competency bundle:

- Brand (marketing, brand awareness, customer expectations)
- Product (financial information)
- Service (customer interaction/interface and transaction execution)
- Intellectual Capital (human capital and applied skill set)
- Cost & Infrastructure Management (value chain management)

The market forces facing financial service providers in the retail sector require "new" core competencies for differentiation. Financial service providers must be sure to differentiate their managerial capabilities: service (customer interface), intellectual capital and infrastructure management. Extending managerial capabilities will provide the greatest value to customers and build competitive advantage.

OBJECTIVES

- Identify the "new" core competencies for financial service providers to compete in the retail sector. These competencies will be identified using a competency pyramid based on the technology trajectories of the retail sector.
- Identify ways to obtain, maintain, and extend core competencies.

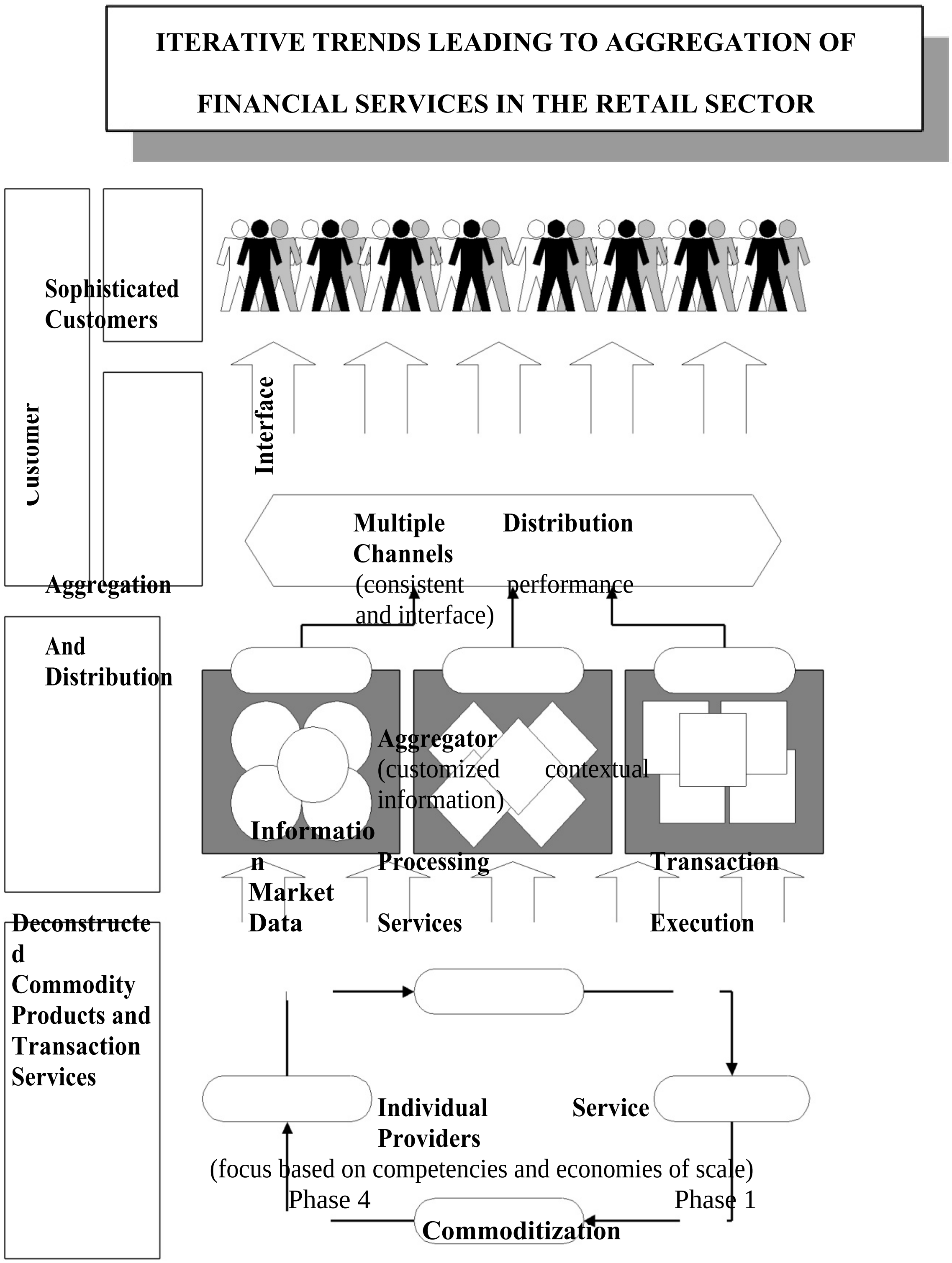
Differentiation: Core competencies a firm should extend in order to procure the greatest value for its customers and most sustainable competitive advantage.

MARKET FACTORS AND TRENDS IN RETAIL FINANCIAL SERVICES

There are persuasive market trends that drive the current migration path to Integrated e-Business Platform for retail financial services. They have a cyclical relationship, driven by technology innovation, increased customer sophistication and the changing regulatory environment.

- Commoditization – products/services becomes easily transferable asset. Standardized across the industry.
- Deconstruction – end-to-end products/services broken into primary (information, service, transaction) components.
- Outsourcing – alliance with external service providers.
- Disintermediation – substitution of direct customer interaction.
- Aggregation – consolidation of separate service, information and transaction components into a unified contextual presentation to end-users (customers).

CHART 1: TRENDS LEADING TO AGGREGATION SERVICES IN THE RETAIL SECTOR



Industry Trends **Drivers**

Technology Innovation

Affecting the Retail Market **Disintermediation** Customer Sophistication **Deconstruction**

Regulation

Competitive Pressures

Phase 3 **Outsourcing** Phase 2

Disintermediation is a major threat to incumbent retail service providers. When it occurs at the customer interface, the firm loses ownership of the customer. The firm risks its franchise; the value of its investment in the client relationship. The lost investment can be considered "sunk costs." This includes any effort to acquire and maintain the customer relationship (discounts, services, cost of sales, etc.). The firm also loses ownership of the future cash flows from that client.

An industry example would be the flight of price sensitive and sophisticated investors from traditional full service brokerage firms to online/discount brokers from 1996 to 2000. Those clients were lost to smaller, more flexible brokers that offered multiple access channels (internet, phone, fax) at significantly lower price points. Traditional retail brokers who lost those clients were disinter mediated in two ways.

- Loss of client relationship (accounts/capital outflow)
- Greater risk of commoditization based on transactional execution competencies.

Instead of focusing on end-users (customers) a firm may change its strategy to develop economies of scale in transaction execution. This allows new entrants to become aggregators and interface with the customer. At is point the firm has become a commoditized service provider, furthest from the points of sale.

Frequently financial service firms choose strategies that provide economies of scale in technical/transaction competencies. Yet the firm decides to extend their competencies outside the firm, in order to improve financial performance. The individual firm may gain substantial ROI from specialization in a specific competency.

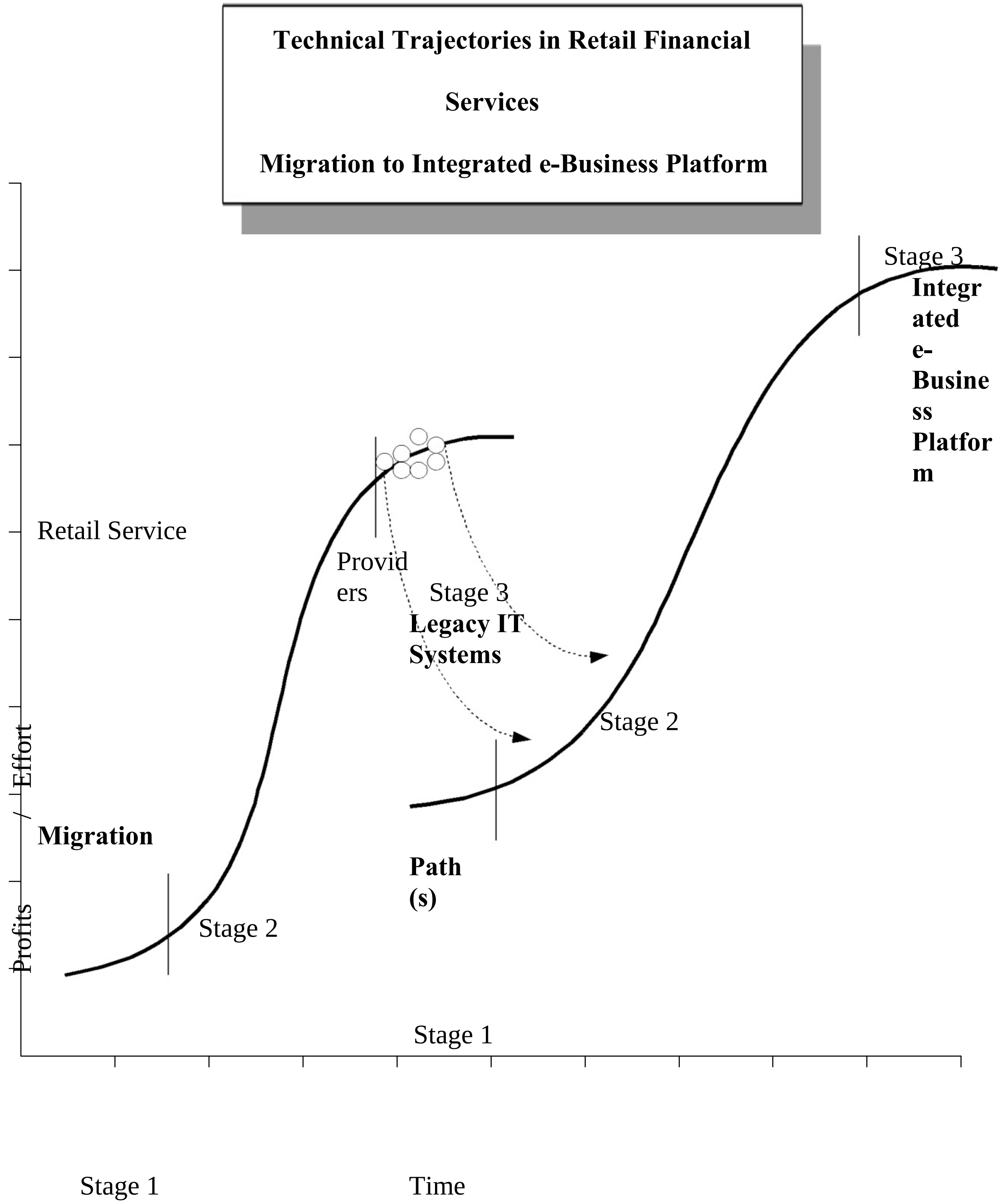
The frequent commoditization and outsourcing of technical competencies effectively reduces the barriers of entry for new competitors. It becomes easier for third party aggregators to leverage commoditized components and enter the retail market. These factors make it difficult to sustain competitive advantages in a technical competency. The only remedy would be patent protection and license fees. Yet most of the technical competencies in financial services are work processes, which can be replicated with common technologies. Therefore technical core competencies may only provide short-term competitive advantage.

The combination of these factors and the timing of technology innovation places substantial pressure on the structure of the financial services industry. Some industry experts postulate that the global financial services infrastructure is destabilizing, due to the reduced barriers of entry brought on by new technologies, deregulation and globalization. The main theme is that these structural changes reduce the income stream of incumbent banks. Productivity gains are negated by reduced profits in a vicious cycle of decline. In the paper, The Business Impact of Information Technology on the Banking Industry, the authors contend that the global banking industry is entering a spiral of decline. The strategic responses of the banks, particularly the trend toward mega mergers and internal cost cutting, are shown to be inefficient in the long term to overcome the reduction of income. Organizations that are locked into legacy infrastructures, inflexible organizational models and business models suffer. They bear the cost of both the legacy infrastructure as well as the implementation cost of new infrastructure to leverage technology innovations and the new regulatory environment.

Technology innovations and increased information have made customers extremely price and feature sensitive. These trends pressure firms to provide consistent service levels and features through multiple distribution channels. Consistency must be maintained across distribution channels that leverage information technology such as the Internet, automated phone systems (VRU – voice response unit), and ATMs (automated teller machine). Additional pressures firms to support multiple infrastructures increases the cost of doing business, for established service providers. On the other hand, these pressures result in a relatively low cost for entry for new retail service providers. For example, total cost for doing business at Merrill Lynch to provide online and traditional retail services is substantially greater than Yahoo's costs to operate their finance portal. Yahoo can offer the same mix of products and services through commoditized service products and alliances with other financial institutions. This level of disintermediation is causing a structural shift within the industry.

Regulatory changes affect on the financial services industry by consolidating market segments into one open access market. In November 1999, President Clinton enacted the Gramm-Leach-Bliley Financial Services Modernization Act. This legislation changed the face of financial service industry in the United States. It allows a financial service firms to consolidate and cross-sell financial products across three major product groups: banking, insurance and securities. The result has been a spate of mergers and acquisitions and strategic alliances.

CHART 2: TECHNICAL TRAJECTORIES IN RETAIL FINANCIAL SERVICES



Market forces, competition and the need to develop sustainable competitive advantage, drive the migration to the new technology trajectory. The long-term result of this migration should be increased long-term profitability.

There is a range of migration paths to the new technology trajectory for Integrated e-Business Platform in the retail market. The majority of the firms making this transition are expending tremendous effort to develop and implement new technical competencies. Yet the short-term effects have placed downward pressures on profits. Most financial service providers in the retail sector are migrating from Legacy IT Systems-Stage 3 (normalized systems, high profits, reached physical limits) to the start of Stage 2 on the Integrated E-Business Platform trajectory (innovation, high effort and cost, increasing performance).

The performance and ROI realized from a complete migration to the Integrated e-Business trajectory will depend on the competencies developed by the firm. Incumbent, traditional retail service providers have the greatest risks during the migration. They face a steep integration period during the migration. The lowered profit levels may not recover until they have fully completed the migration to an Integrated E-Business Platform. Even then, it may take longer than expected to surpass the profit levels enjoyed with Legacy IT Systems (Stage 3).

CORE COMPETENCIES FOR RETAIL FINANCIAL SERVICES

There exists a large body of research on competency bundles and developing competitive advantage in the financial services industry. The primary contributors to this area of study are:

- Consultants (management and technology firms)
- Universities (business schools, economics departments)
- Government Agencies (Federal Reserve, SEC)
- Industry Organizations
- Trade Journals

There are common themes in the current body of research, which identify the competency bundle for retail financial services.

There are five core competencies that are required for a firm to successfully compete in the retail market. Each competency is aligned to a functional group in the firm. The competencies require certain skill sets to be manifest in the daily operations of the firm. Each core competency has a direct relation to customer value. As we consider the five core competencies in detail, we will also identify which competencies and skill sets must be developed and retained within a firm in order to reap the greatest customer value. Increased customer value will lead to increased revenues, and profits.

TABLE 1: CORE COMPETENCIES FOR RETAIL FINANCIAL SERVICE PROVIDERS

Brand	-Marketing -Sales	-Advertising -Manage customer Expectations	-Brand awareness, reputation -Managed performance expectations -Deepen trust, and customer relationship, loyalty -Increased wallet share, up-sell high margin products -Increased profit per customer
Product	-Marketing (product development)	-Product knowledge -Multi channel distribution -Differential pricing -Mass customization	-Products/features aligned to appropriate customers -Superior product performance (speed, reliability, accuracy, price, investment returns) -Convenient for customer -Customer loyalty
Service Customer Interface & Transaction Execution	-Customer Support -Sales -Operations -Technology (IT)	-Customer interaction management -CRM: customer resource management -Data mining -Data Processing (transaction execution) -Data Communications	-Context information tailored to customer needs and preferences -Consistent information across all delivery channels -Customer satisfaction, loyalty
Intellectual Capital	(All Employees)	-Technical skills	-Employees enabled

	-Marketing (product development) -Technology (IT) -Legal -Human Resources	(data analysis, programming, modeling) -Specialized product knowledge (expert) -Knowledge Management Infrastructure -Human Resource Management -Continuous Improvement (continuous learning)	and empowered to add value to customer interaction at point of sale. -Identify new revenue sources from intellectual property.
Cost & Infrastructure	-Senior Management -Line Managers -Technology (IT) -Legal	-Organization & Systems Architecture -Work process design -Value chain management (partners, suppliers) -Risk Management -Cost Management -Systems and work process integration -Regulatory compliance -Security	-Flexible organization and systems to integrate new innovations. -Rapid response to customer preferences and market changes. -Improved financial performance (revenues, profits, shareholder value)

Each competency and related skill set map directly to a managerial capability or technical competency. The managerial competencies should be the primary focus in order to develop a sustainable competitive advantage in the retail market. Each competency and skill set is mapped using a competency pyramid to determine the relative value added and the best strategy for the retail market.

TABLE 2: COMPETENCY PYRAMID FOR RETAIL FINANCIAL SERVICE PROVIDERS

Managerial Capabilities		1-Resource Management		
	2- Management Information Systems (Risk, Costs, HR)	2-Value Chain Management, Product Development		
	3- Knowledge Management System, Customer Resource Management (CRM)	3-Marketing, Brand Development		
	4-Customer Interface Systems (Web portal, VRU, ATM)	4-Customer Management		
Technical Competencies		1-Staff, Consultants, Strategic Partners	1-Facilities Management	
		2-Product Knowledge	2-Systems Integration, Data processing & communications	
		3-Knowledge Transfer, Change Management Process		
	4-Point of Sale: customer interaction	4-Product/Service Design		

BRAND

Brand development relates directly to the sales and marketing groups with the firm. The skills sets required include advertising and managing customer expectations. Managing customer expectations is extremely important because that is how a firm interacts with the customer. The firm attracts customers by promoting their brand and setting customer expectations. The customer enters the business relationship with the expectation that the firm will meet their financial needs. By developing brand awareness, a firm can extend its value in the marketplace. A firm that successfully manages its brand will add value to the customer by increasing trust and customer satisfaction. A firm can also deepen its relationship with the customer and gain wallet-share, by up-selling high margin products. Developing a strong brand is key to differentiating a firm from its competition.

PRODUCT

Product development is the responsibility of marketing, sales and, the IT groups in the firm. These products need to be flexible, support mass customization and leverage multiple distribution channels. Differential pricing is a required skill set. The pricing schemes are based on customer value, not just cost margins. The products value to the customer is based on aligning appropriate features to meet the needs of the individual customer. This is accomplished through consistent performance across all distribution channels, with features available on demand.

SERVICE

The service competency has two components: customer interface and transaction execution. These two components have overlapping skill sets, yet they provide different value propositions to the customer and stakeholders. The customer interface is the responsibility of all parts of the organization that has direct interaction with the customer. Sales, customer support call centers, customer web portals, VRU (voice response system) and written correspondence are all components of the customer interface. The primary skills required to develop and enhance the customer interface are data processing, Internet technology, CRM, and customer interaction management. This includes training, empowering employees and creating knowledge embedded systems to manage customer requests on demand. The development of the customer interface will strengthen the one-to-one relationship with the customer. This provides a basis for sustained competitive advantage.

INTELLECTUAL CAPITAL

All employees are involved in developing the intellectual capital of the firm. It is management's responsibility to identify and transform "know-how" into accessible knowledge and skills across the enterprise. The primary skill sets required to build intellectual capital in a firm are knowledge management, human resource management, technical and product knowledge. These skills will provide the firm with a diverse talent pool and the means to distribute their skills throughout the organization.

COST AND INFRASTRUCTURE

Senior management, line managers and IT groups are primarily responsible for the cost and infrastructure competencies. The primary skill sets would include flexible organization and systems integration, value chain management, risk/cost management, legal/regulatory compliance and security. These skill sets provide the basis for rapidly responding to changes in the retail market. It allows the firm to quickly adjust is product and services to address customer needs and target new customer groups. The ultimate result of this competency is superior financial performance and increased shareholder value.

CONCLUSION

A firm in the retail sector of financial services will need to develop five competencies:

- Brand
- Product
- Service
- Intellectual Capital
- Cost and Infrastructure Management

A firm will need to evaluate its relative ranking with is competitors and other market participants. One must identify ways to build these competencies within the organization. An organization may use industry experts and consultants to transfer the required knowledge to the critical personnel in the firm. One may also attract talented professionals from rivals or related industries. Also a firm can enhance its skills by completing projects, which require the development of the desired skill sets and competencies.

A firm in the retail sector should invest and develop competencies in the customer interface and brand management, because those are the distinguishing characteristics of the firm in the retail market. These competencies would closely leverage skill sets in cost and infrastructure such as value chain management. A firm should develop its brand and customer interface to add value to its customers, thereby increasing client trust and deepening wallet share.

Brand and the customer interface are the key differentiators amongst firms in the retail market. Focusing on these competencies can provide significant competitive advantages. This is especially true when compared to firms with transactional competencies. It is extremely difficult to differentiate as innovations are rapidly adopted by the industry. Technologies with exceptional performance characteristics quickly become commoditized into common goods. The keys to sustained competitive advantage in retail financial services are a strong brand and a consistent value added customer interface.

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