

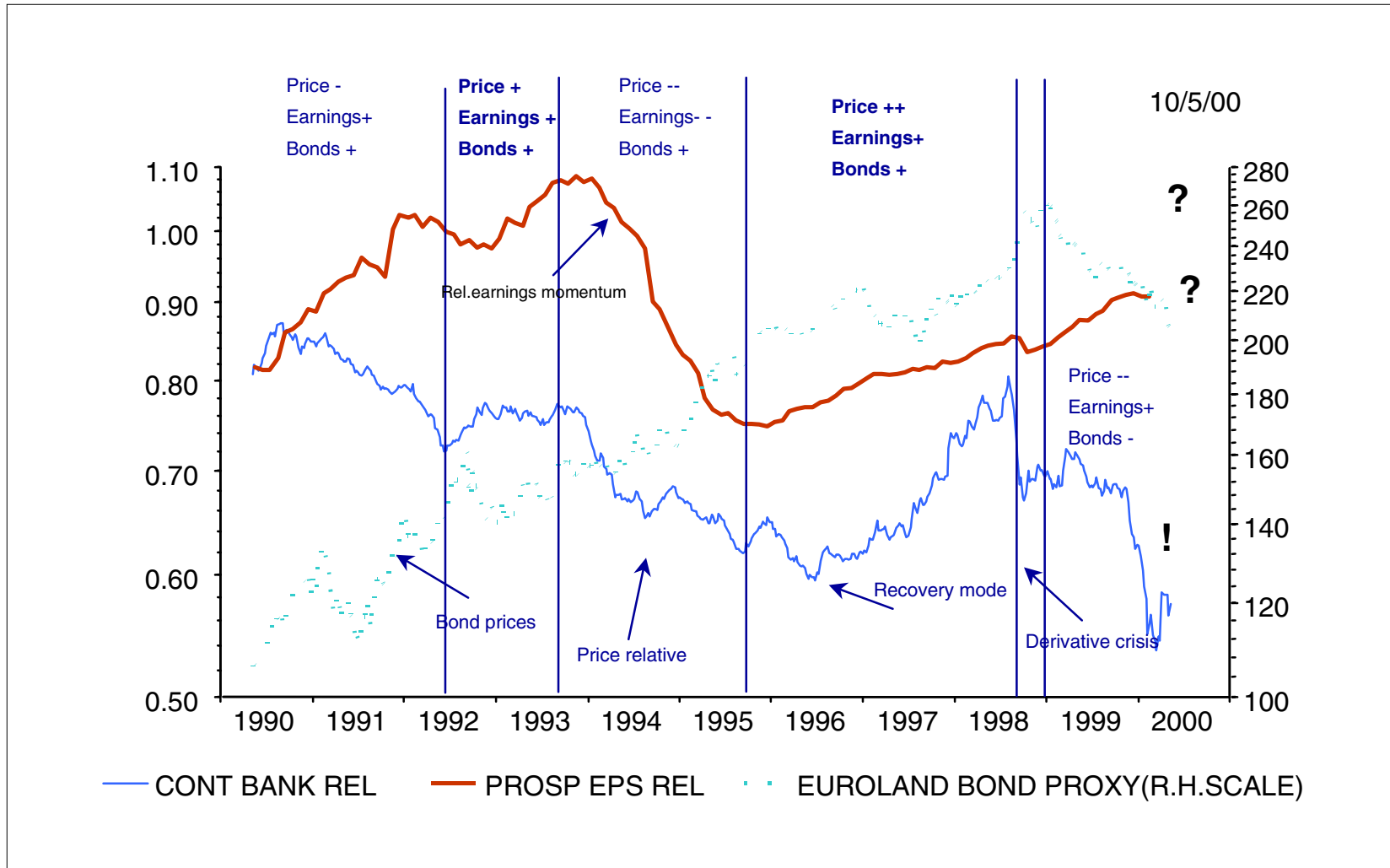
# e-banking Review

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Spain, Portugal, Strategy

- EPS paradox
- The economic cycle
- Retail Wholesale debate
- Top recommendations

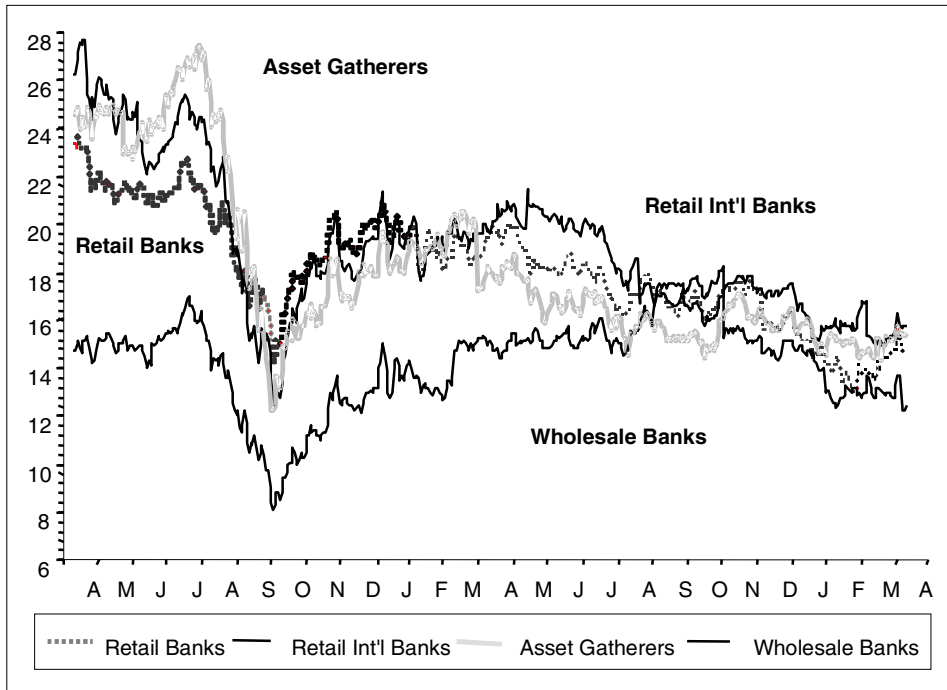


# Sector De-coupled from EPS Momentum. Bonds Peaking?



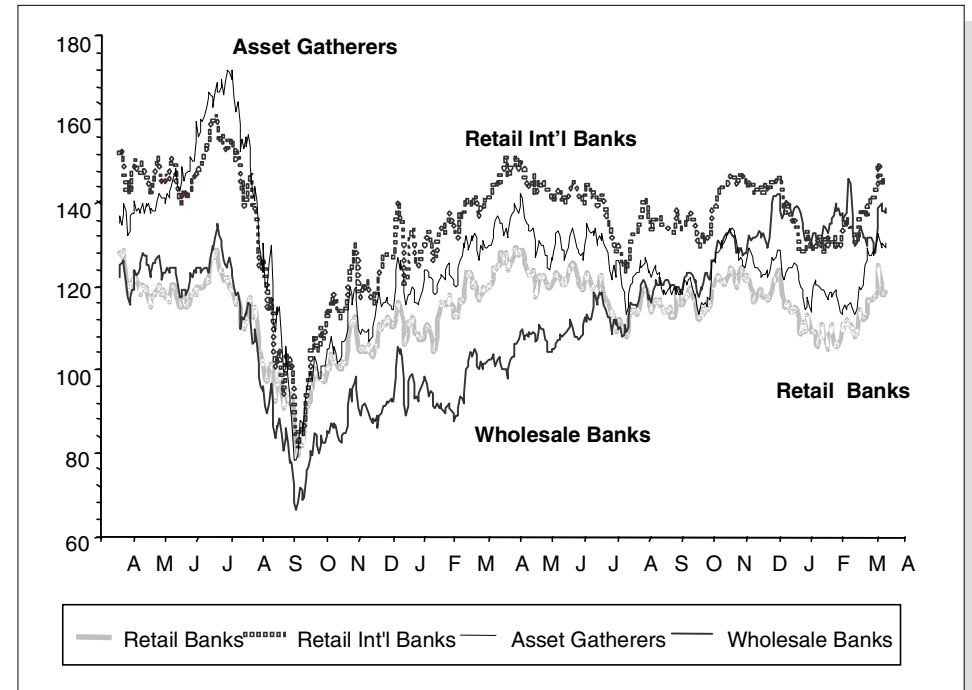
Source: Datastream

## P/E by Type of Bank



Source: Datastream, Merrill Lynch

## Market Performance by Type of Bank



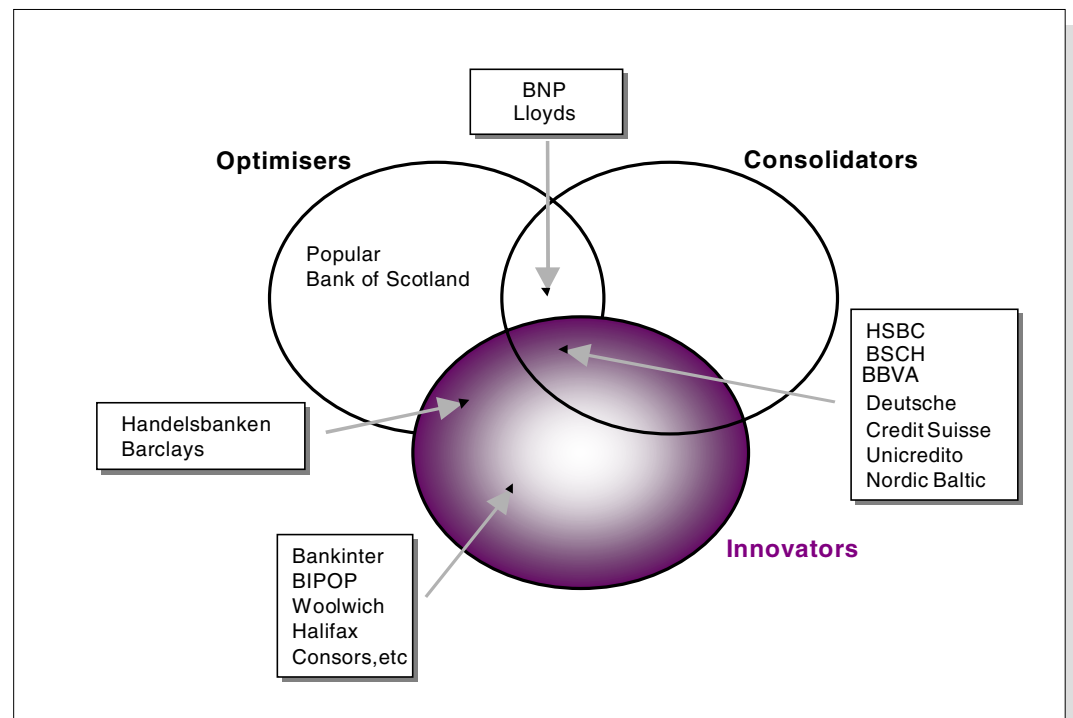
Source: Datastream, Merrill Lynch

## Recommendations:

**Large Players: HSBC, BSCH, Unicredito**

**Niche Players: Bankinter, Halifax**

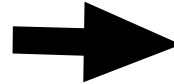
## Favoured Strategies and Banks



Source: Merrill Lynch

- The World is changing
  - Increasing competition
  - Cross Subsidisation
- Margin Pressure (driven by established banks)
- Convergence of Models
  - The US experience
  - Established and pure e-banks need to change
- Bottom up approach

- Information availability = price transparency = margin squeeze



- De-commoditise the product
- Manage change with **cost rationalisation**

- New channels (branches no longer sine qua non of banking)



- **First entrant** in the market
- Raise entry barriers with **brand** and **economies of scale**
- **Alliance with TMT**

- Cross-border competition



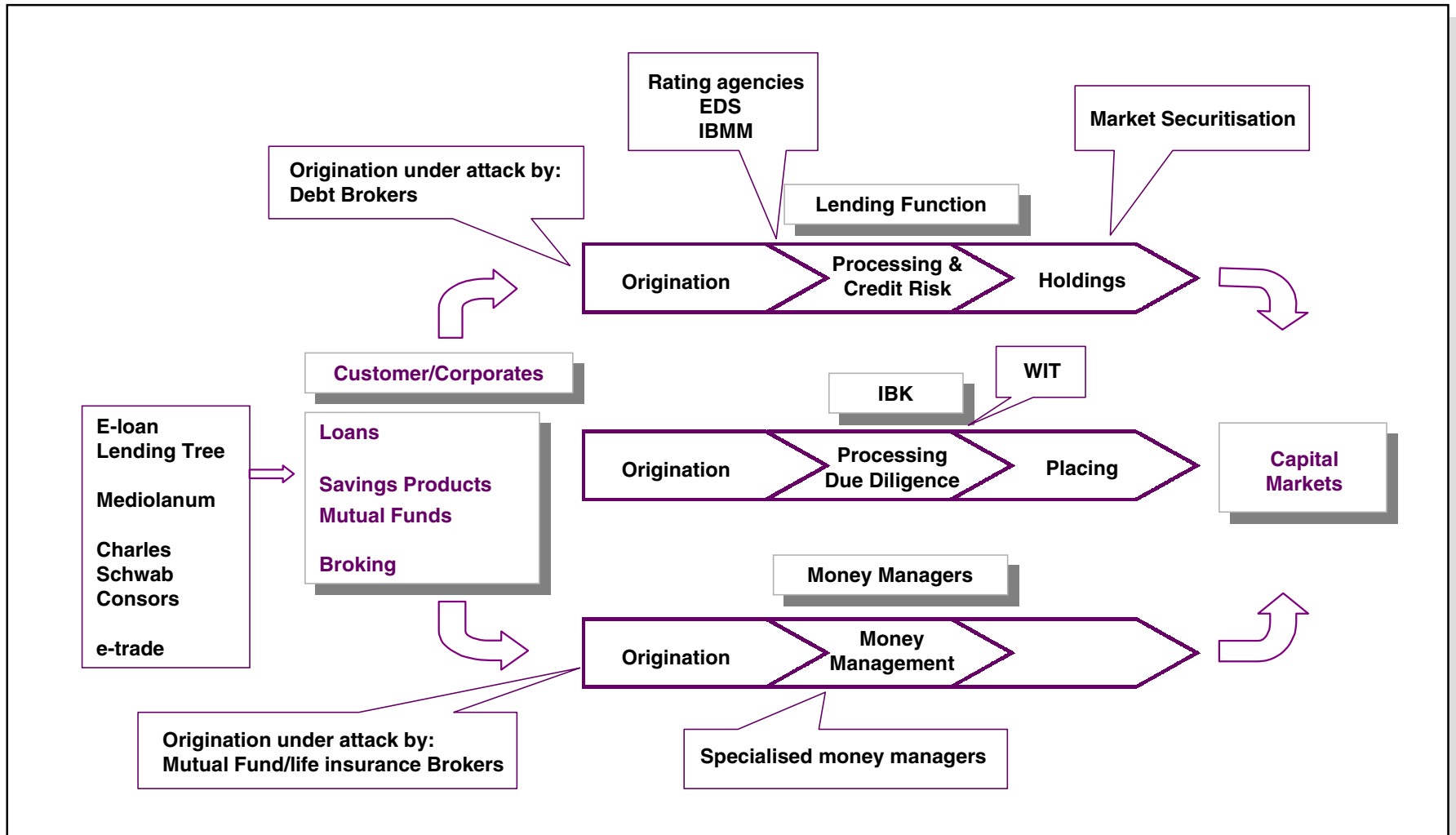
- Partners with local know-how for **Pan-EU internet launch**

- The aggregator threat



- Deconstruct value chain in:
  - a) Manufacturing (unit costs/size)
  - b) Distribution (multi-channel)
  - c) Customer relationship (brand)

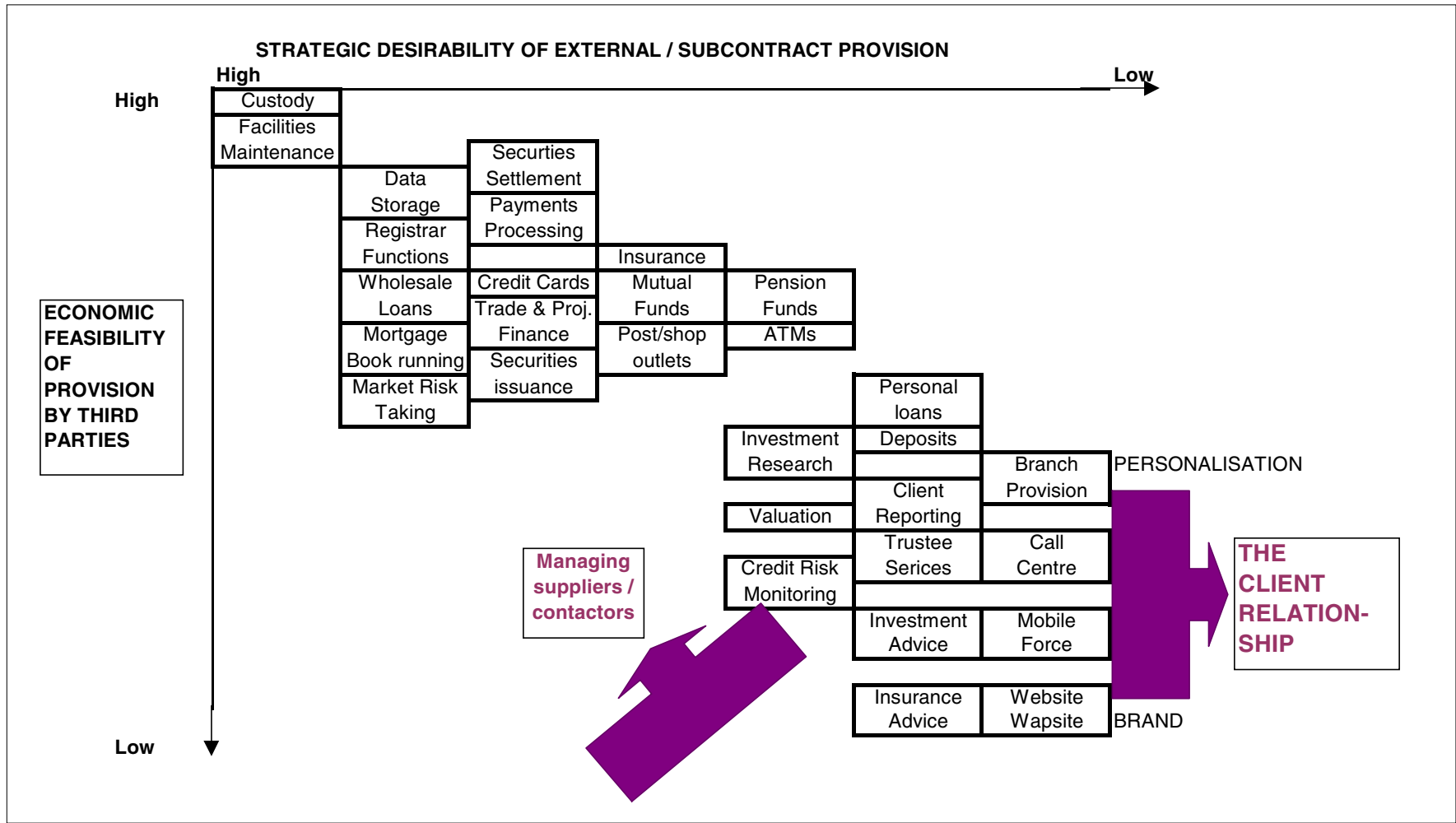
# Deconstructing the Banks Value Chain

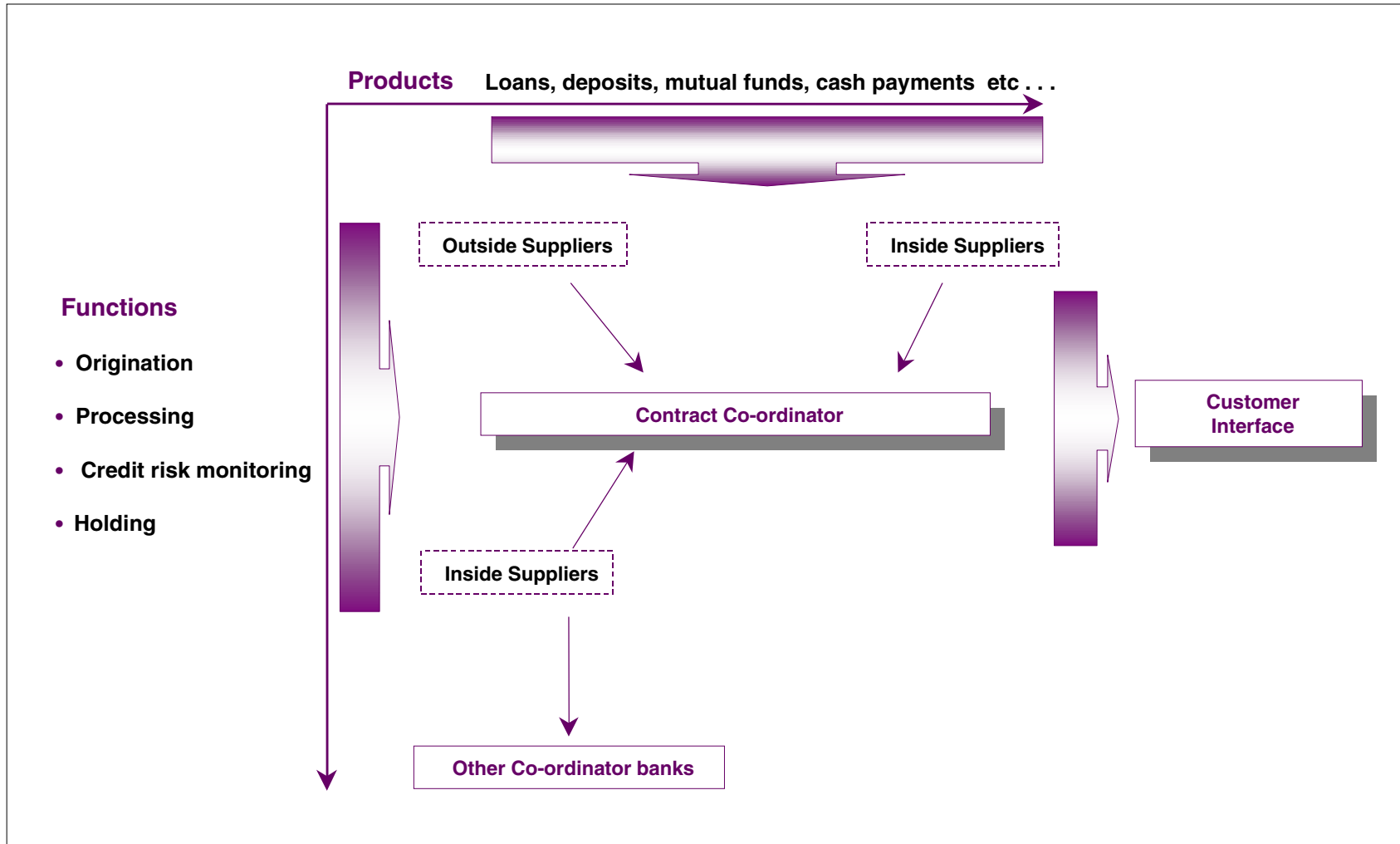




# Deconstructing What Does de-Constructing the Value Chain Mean?

- More and more functions can be provided by 3rd parties, making new market entry easier

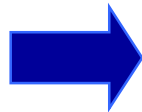




- Cross subsidisation between products / clients makes universal banks vulnerable
- New entrants / attackers focus on subsidising products
  - Mortgages
  - Mutual funds
  - Life insurance, etc
  - See example of new IF initiative
- ... or on subsidising clients
  - HNW individuals
  - Affluent clients

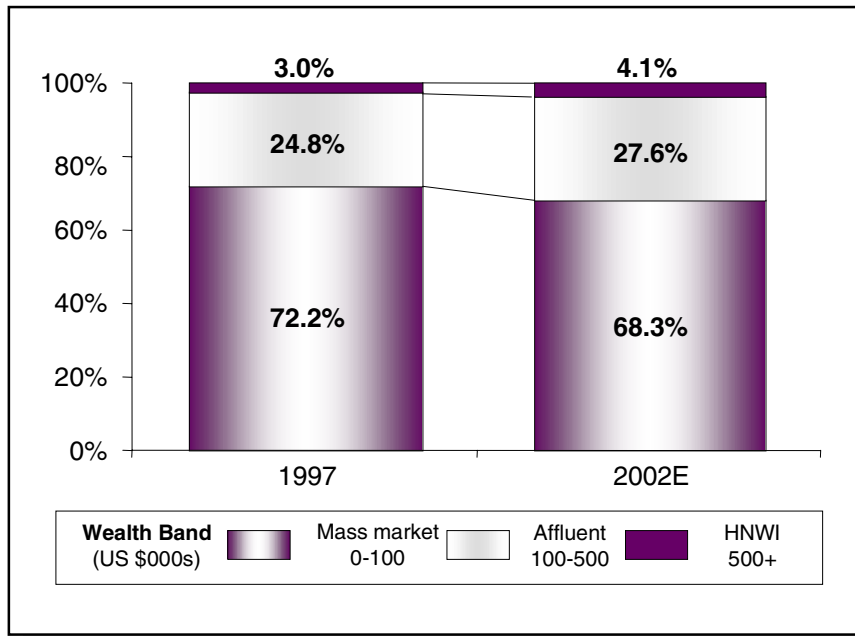
**Increasing competition from:**

- e-banks
- new entrants: retailers
- but above all.. aggressive established banks

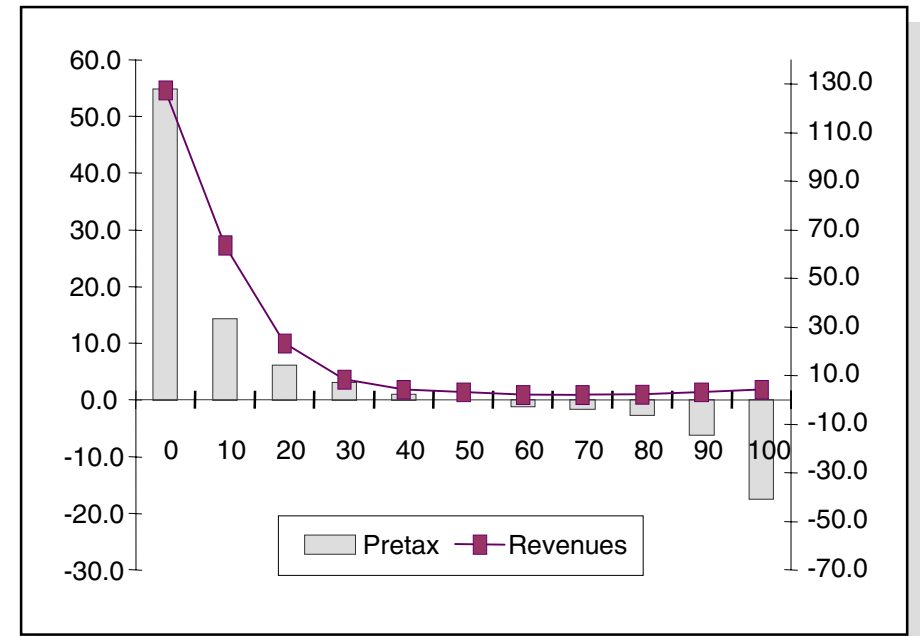


# What Does De-constructing the Value Chain Mean?

## Wealth Distribution in Europe



## Net Profit Distribution per Client in French banking



- Picking the best clients = Targeting mass-affluent & HNWI's part of response

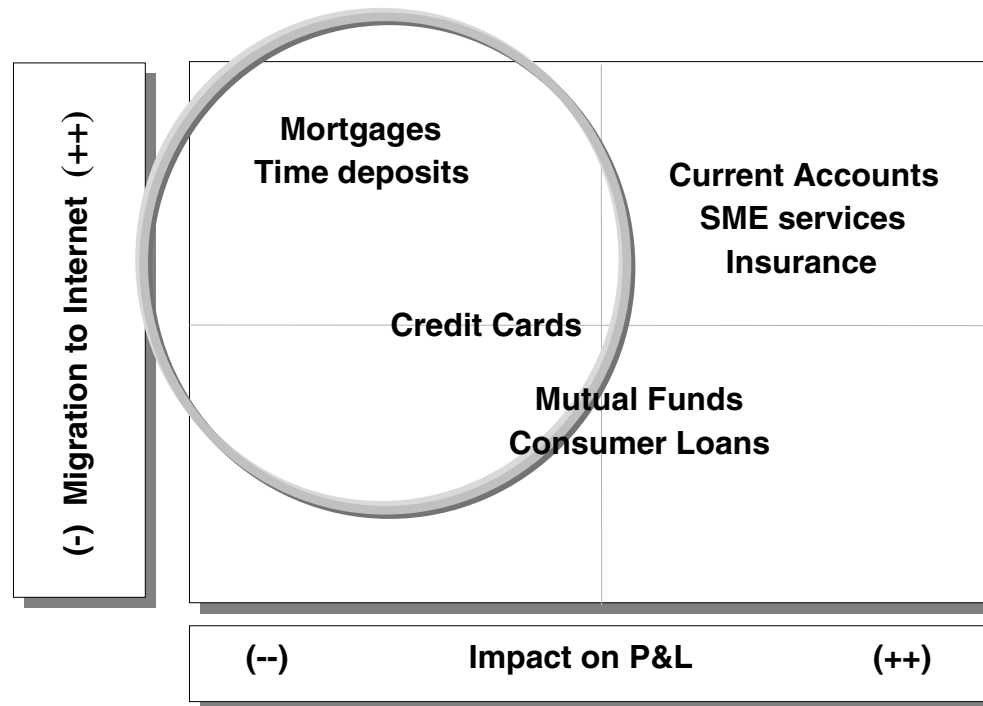


Customer relationship management:  
IT, brand, sales force

# Which Banks are More at Risk?: (I) By Product Cluster

**Banks exposed to  
dangerous *product mix***

## Products Easily Targeted by New Entrants

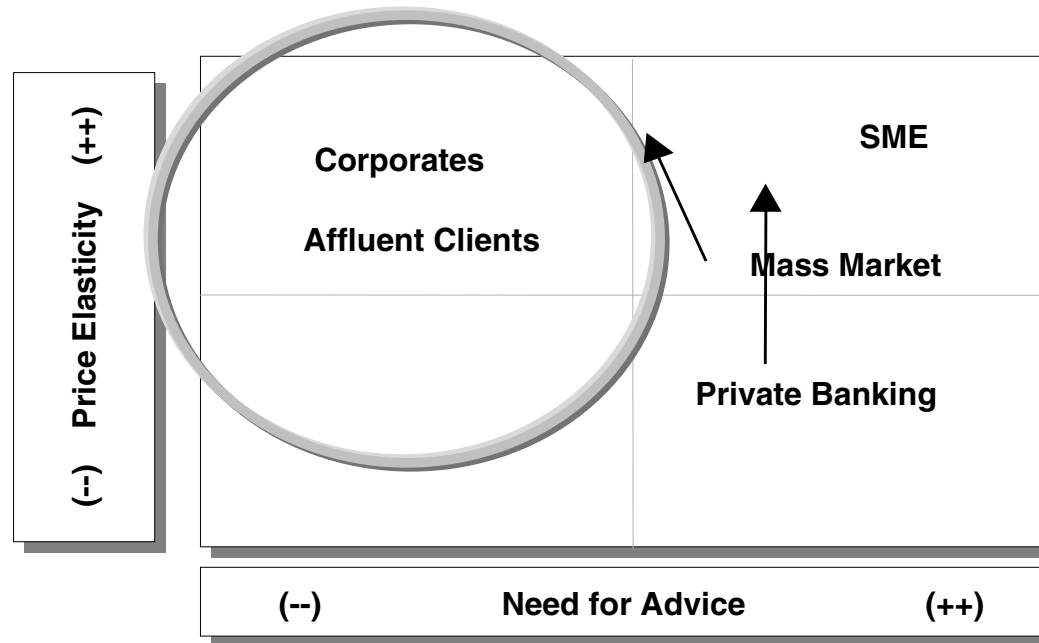


Source: Merrill Lynch

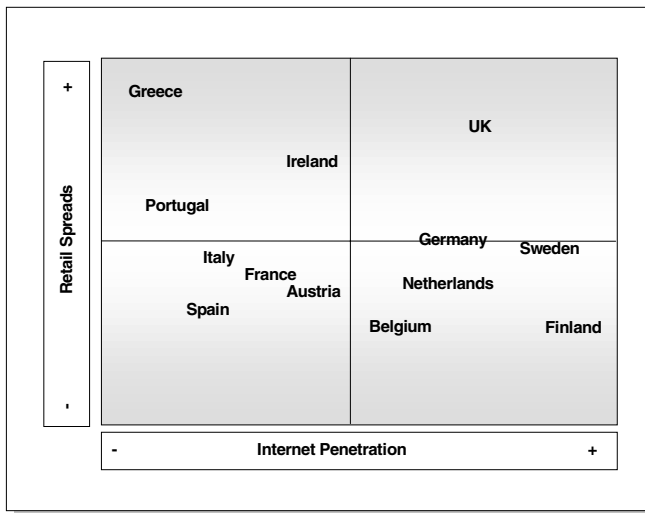
# Which Banks are More at Risk?: (II) By Client Cluster

**Banks exposed to dangerous *client mix***

## Clients Easily Targeted by New Entrants



Source: Merrill Lynch



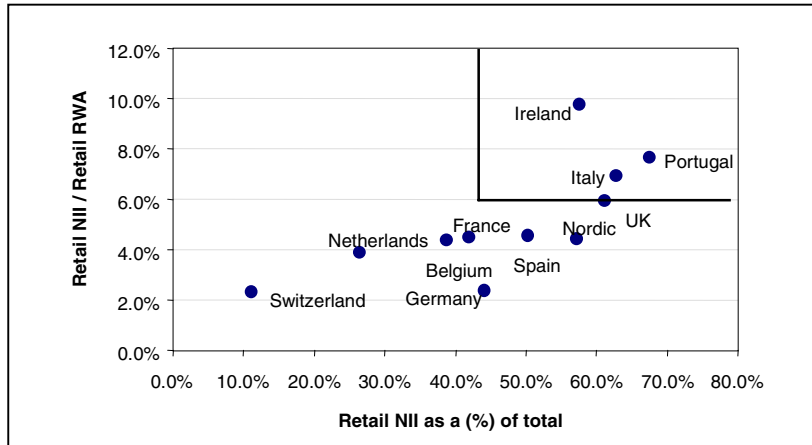
Ireland, UK, Portugal and Greece on the high margin area (see appendix)

	Consumer	Fixed Mortgage	ST SME	Current Accounts	Saving Accounts	Time Deposits
Greece	11.6	1.40	5.1	2.95	1.5	1.6
Sweden	5.4	1.70	1.68	3.25		2.22
UK	9.4	1.39	na	na	3.84	1.31
Netherlands	0.0	0.71	0.5	3.25	na	-0.15
Belgium	3.5	0.69	3.69	na	0.89	0.58
Germany	6.7	0.69	4.43	2.54	1.47	1.18
France	4.7	0.66	1.35	na	1.08	0.16
Italy	na	0.70	2.32	3.25	1.94	na
Austria	3.3	na	2.61	1.96	na	1.19
Portugal	5.6	na	4.05	na	0.95	0.66
Spain	4.5	0.50	1.14	1.62	1.55	0.94
Finland	2.6	na	0.98	2.80	2.21	-0.14
Ireland	7.2	na	5.26	na	3.33	na
<b>Average</b>	<b>5.4</b>	<b>0.9</b>	<b>2.8</b>	<b>2.7</b>	<b>1.9</b>	<b>0.9</b>

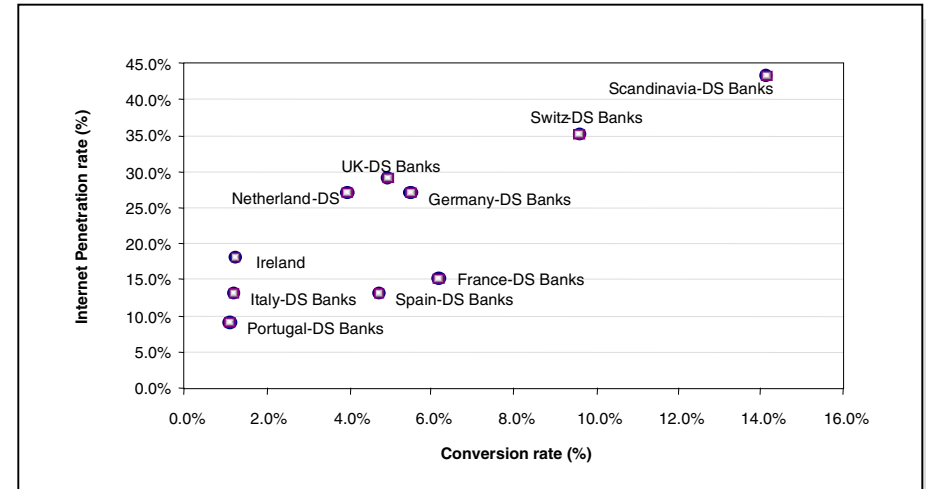
(\*) Prices are not fully comparable due to legal and tax issues

Source: ECB and Merrill Lynch

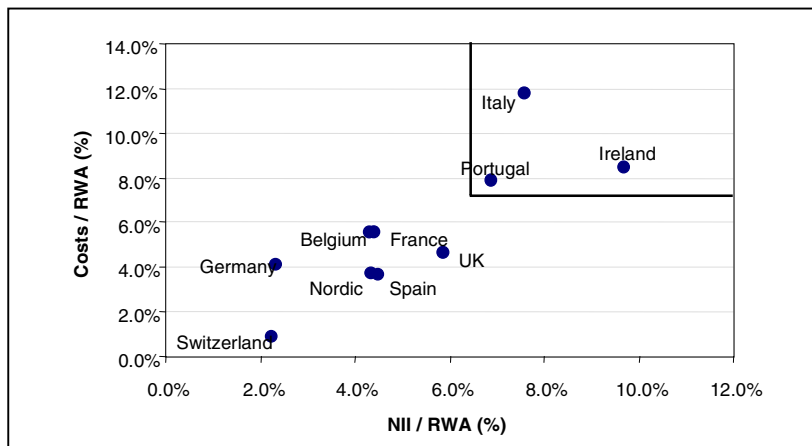
## Margins and Retail Exposure by Country



## Margins and Conversion Rates by Country



## Margins and Costs by Country



- Ireland, Portugal, Italy and the UK combine high retail exposure and high margin
- Ireland, Portugal and Ireland also have high cost base and low conversion rates
- Best combination of margins, costs and relative conversion are Nordics, Spain, France and Germany



## ■ The US Experience

- Slow take up
- Need to keep expensive customer relationship centres
- ... because customer behaviour is additive not substitutive
- Failure of pure e-banks based on pricing (Net Bank, Wingspan,...)

### US Online Banking Penetration

	1998	1999	2000	2001	2002	2003
Online Households	37.6	44.9	51.5	57.2	62.6	67.6
Online Banking Households	3.8	6.4	10.2	14.0	19.4	26.4
Online Banking HH as % of all US HH	3.8	6.3	9.9	13.5	18.4	24.7
Online Banking HH as a % of Online HH	10.2	14.2	19.8	24.6	20.9	39.0

Source: Jupiter Communications

### Problems of e-banks

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- Lack of customer relationship
- Niche market
- Service
- Infrastructure penetration

### Problems of established banks

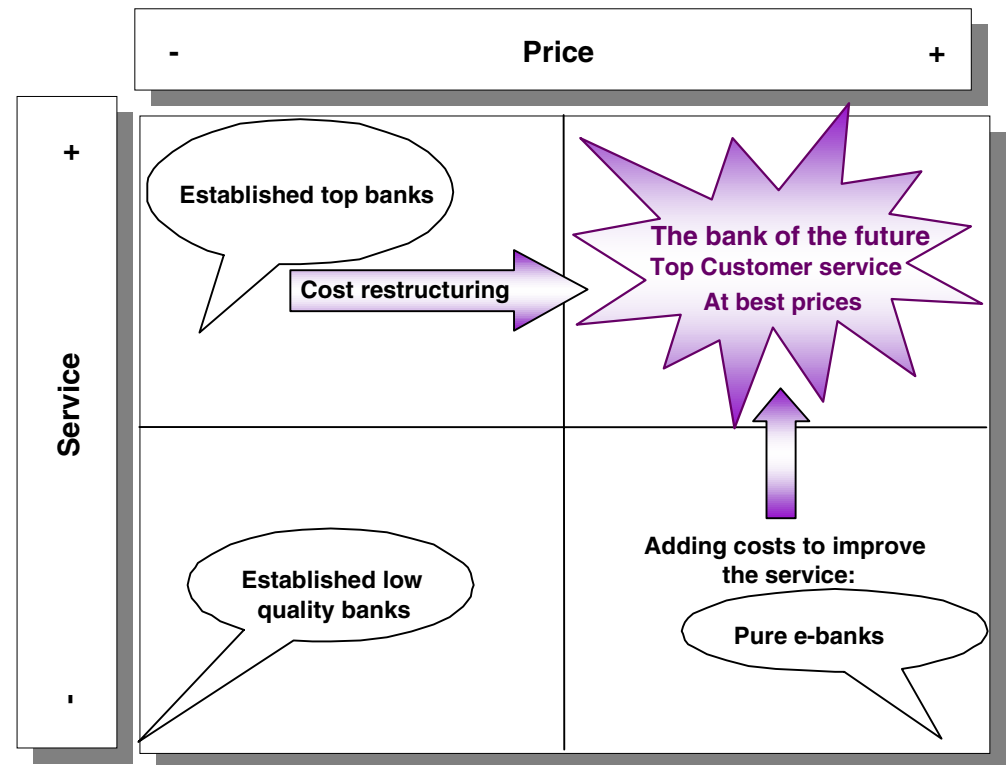
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- Lack of competitive pricing
- Cross subsidies
- Not taking advantage of strengths: pool of customers, client knowledge

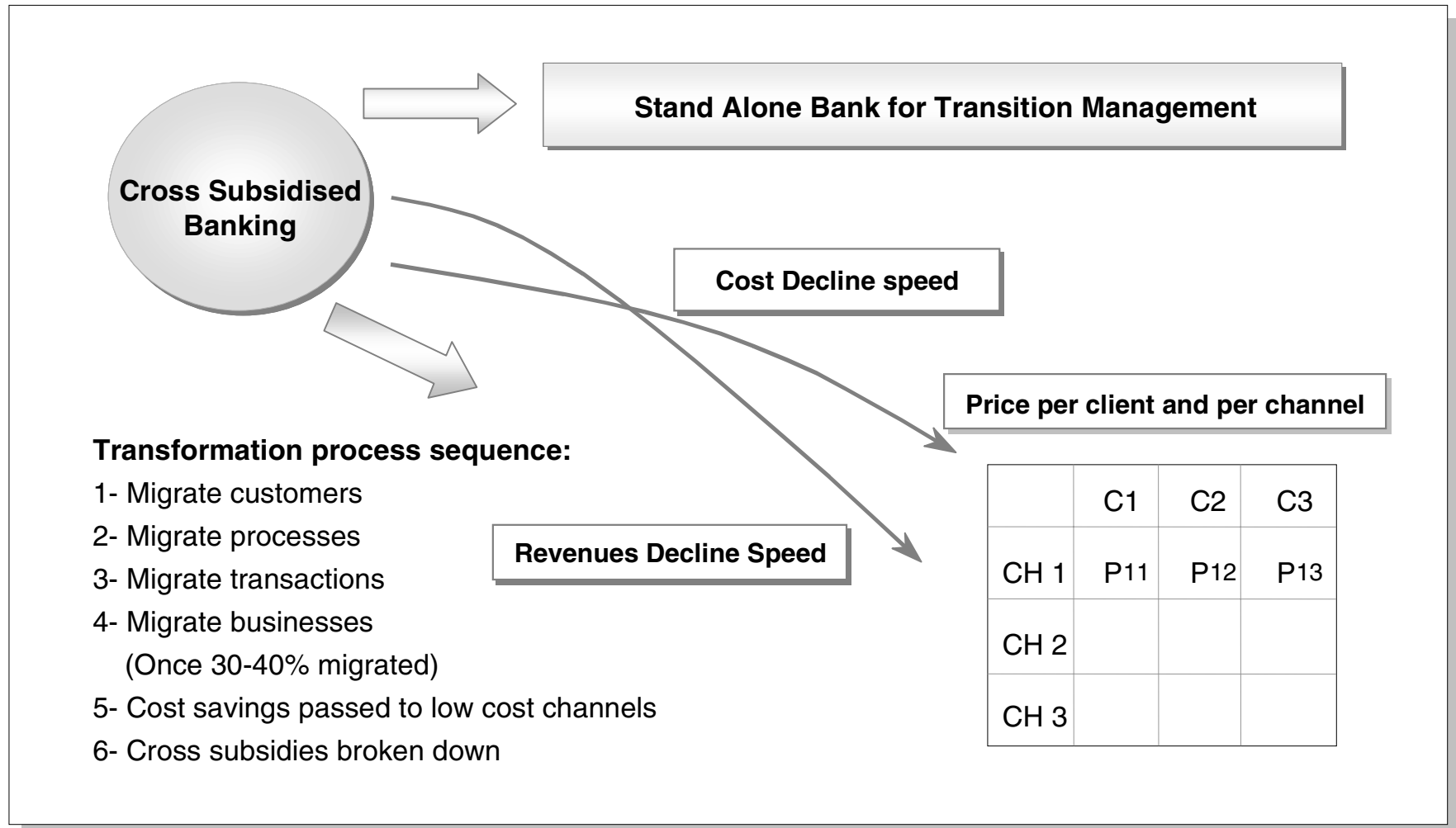
## First Banks to Reach Click & Mortar Status Should be Winners

- Few banks approaching that status:
  - It is a relative status
  - BIPOP
  - Bankinter
  - Nordic Banks

### Convergence of Models



Source: Merrill Lynch



## The Magic Formula

**Market share  
(economies of scale)**

X

**Share of wallet**

X

**Efficiency**

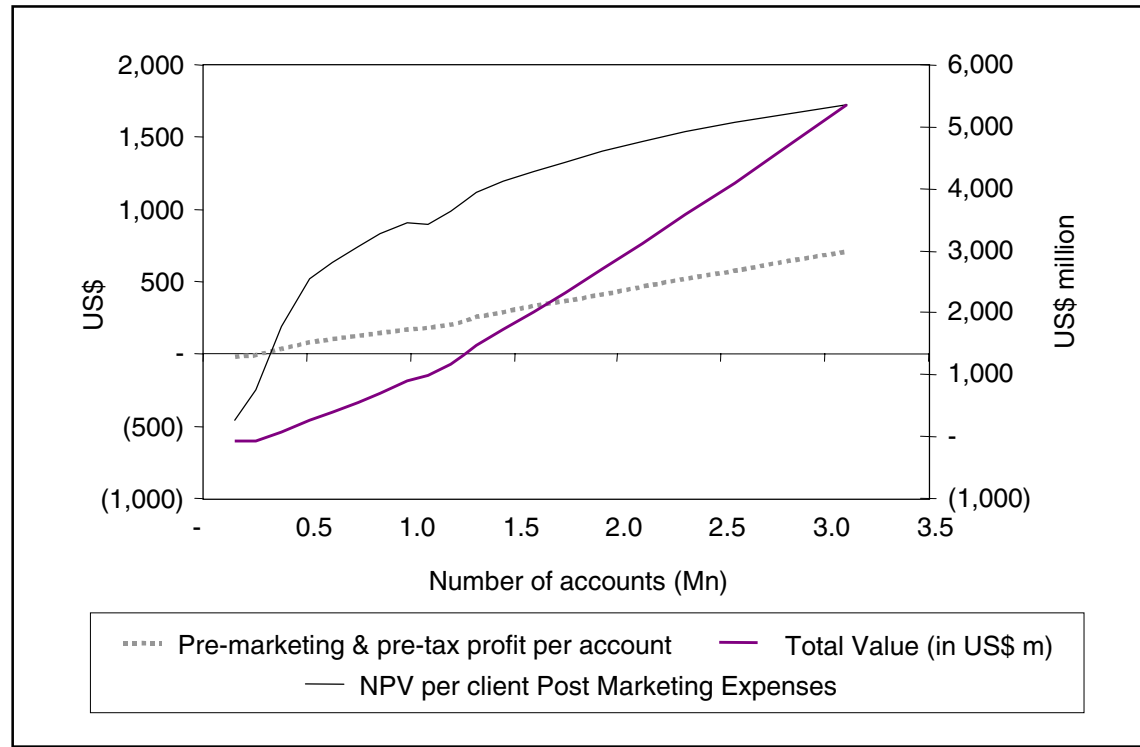
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**Top ROE**

- Re-engineer processes
  - Prepare for a world of more demands at a lower price
  - Client migration
- Customer centric banking
  - First relationships more important
- Top IT
  - To engineer the restructuring and the CRM
- Growth strategies
  - Strong growth in emerging markets
- TMT alliances
  - Control of access to new channels
  - Convergence: co-operation, competition or mergers?

- Economies of scale
  - Human talent and marketing expenses
  - Difficulties in Europe
  - (See following page case)
- Service improvement
  - Call centres
  - Some bricks
- Partnerships with the old economy
  - Retailers
  - Utilities?

## Patagon (Spain) Value Depending of Economies of Scale



- Management that understand core competences (distribution, production or both) - A vision
- Customer centric banking (first banking relationships)
- Aggressive restructuring is a must
  - Automation of processes
  - Migration of transactions on line, etc
- IT: without it nothing can be achieved
- TMT alliances (co-operation model)
- Vision: on-line banking lowers entry barriers and provides opportunities for aggressive established banks
- Economies of scale: minimum size



	UK	Germany	Iberia	France	Italy	Nordic	Switzerland
<b><i>Established Banks e-banking winners</i></b>	Barclays, HSBC, Halifax, Woolwich	Deutsche	Bankinter, BBVA, BSCH, BCP	BNP	Unicredito, BIPOP	Nordic Baltic, Handles	Credit Suisse
<b><i>Established Banks e-banking losers</i></b>	Northern Rock, Alliance & Leicester, Lloyds (?)	Dresdner	Small banks and savings banks, Popular (?)	Credit Lyonnais	Small banks Banca di Roma	Real Danmark (Kapital)	Julius Baer