MARKETING STRATEGIES: INNOVATIVE FINANCIAL SERVICES – DETERMINING OR OVERCOMING THE CRISIS

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Abstract. The financial crisis is believed to have a triple root: a policy of easy money kept going too long, an international securitization of heterogeneous debts whose structuring was almost incomprehensible, and a lax regulating attitude, largely tolerated by supervisory authorities. Financial innovation has managed to transform illiquid and risky instruments into apparently safe and liquid assets. In order to overcome this crisis, banks will have to implement new marketing strategies and reposition themselves towards a more careful risk evaluation. The main measures adopted are related to improving sales productivity, developing innovative services, using remote channels, pricing and risk management, origination and servicing optimization, IT optimization.

Keywords: innovative financial services, marketing strategies, the banking system, financial crisis

1. Introduction

Given the fact that year 2009 positioned retail banks at a crossroad, they will have to implement significant changes if they want to remain successful over the next years. Retail banks should continue to develop sales, rather than relying exclusively on cost reduction.

Reducing cost, primarily through geographic consolidation of middle and back offices as well as IT systems, should be a top priority for retail banks, but in the context of the current financial crisis, cutting costs is not a sufficient measure, due to high fixed costs and uncertain revenue streams.

Thus, banks should give equal priority to the development of sales and innovative services, especially by improving cross-selling capabilities, product bundling, and customer-based pricing. They also need to use marketing strategies in order to find and attract new, lower-net-worth clients to increase volume. The challenge will be to consider a new approach to customer selection, for safeguarding against increased risk.

As the global financial meltdown spreads, financial brands have been profoundly damaged also by a crisis of confidence among their stakeholders, which entail specific marketing efforts for re-establishing the trust [1].

2. Financial Sector Innovation

Some authors believe that the core of the present crisis was the interplay between macroeconomic imbalances which have become particularly prevalent over the last 10-15 years, and financial market developments which have been going on for 30 years but accelerated over the last ten under the influence of the macro imbalances.

According to this statement, the fundamental macro economic imbalances have stimulated demands met by financial innovation, focused on the origination, packaging, trading and distribution of securitised credit instruments.

Simple forms of securitised credit - corporate bonds - have existed for almost as long as modern banking. But it was from the mid-1990s that the system entered explosive growth in both scale and complexity:
- Huge growth in the value of the total stock of credit securities
- An explosion in the complexity of the securities sold
- The related explosion of the volume of credit derivatives.

This explosion was supported by and in itself drove big increases in the leverage of major financial institutions - in particular investment banks and the investment banking activities of some large universal banks.

As a result of the falling of the risk aversion, credit spreads on a wide range of securities and reaches inadequate levels, the price charged for the absorption of volatility risk was falling because volatility seemed to have declined, all these fuelling in turn higher apparent profits and higher bonuses, thus reinforcing management and traders certainty that the evolution was correct [2].

Weaknesses and failures in financial markets played a major role in the build up to the crisis. Over the last decade, financial innovation has been organized to "transform" illiquid and risky instruments into apparently safe and liquid assets. During that period, rating agencies, accounting rules, unregulated and off-balance-sheet entities as well as very poor risk management all contributed to weaken financial systems.

Creating a new regulatory regime and strengthening the supervisory arrangements are at the forefront of efforts conducted for overcoming the crisis [3].

3. The Implications of the Financial Crisis for Banking System

The present market conditions are dramatically changed: a declining economy, heightened funding requirements (Basel II constraints, limited access through securitisation), and the increasing cost of client risk.

Thus, retail banks have to rethink their business models: a new deposit-based approach appears to be the substitute for the past credit-based model - banks with deposits and therefore a higher capability to fund and transform those deposits into credits are about to become the most successful ones.

For several years, credit, and notably mortgage, used to drive retail bank growth. But, in 2008 the crisis marked a clear stop to positive trends in the mortgage market, with an explosion in funding costs having a dramatic impact on mortgage profitability, due to the brutal downturn in housing prices.

In today’s context, with no access to deposits and no direct cross-selling opportunities, mortgage specialists will have to lean on diversified retail banks to get through the crisis. This would help mortgages become profitable again in the medium term, as the result of a lower supply [4].

Larger use of technology and outsourcing of processes will have a positive impact on the transformed, post-crash, global banking system going forward, whereas IT has transformed banking processes, and, along with an accelerating use of onshore and offshore outsourcing, has helped to drive down costs, and increase profitability [5].

4. How can Banks overcome the Financial Crisis

In the crisis context, banks are looking for key opportunities and activities to address the challenges related to this new market situation. Marketing strategies are going to play an important role at this part.

A qualitative bank survey conducted in 2009 by Capgemini, the European Financial Management&Marketing Association (EFMA) and UniCredit on fifty-four large retail banks in seventeen selected countries (including Romania) relieves some top opportunities for addressing these challenges, over the next five years.

They identified six key opportunities:

- Related to marketing and sales:
- Improving mortgage sales productivity and capabilities;
- Developing innovative services;
- Using remote channels;
- Related to pricing and risk:
- Pricing and risk management;
- Related to middle/back office and IT:
- Origination and servicing optimization;
- IT optimization.

Among them, the “Improving mortgage sales productivity and capabilities” opportunity and the “Pricing and risk management” opportunity are the most important, having been cited by over half of the surveyed banks.

1. Improving mortgage sales productivity and capabilities is the first overall and is considered a key opportunity in all regions, thus retail banks need to initiate three critical activities:

- Improve cross-selling capabilities - is the most critical approach to improving sales productivity. Nearly 80% of the respondents aim to develop the cross-selling capabilities of their sales forces over the next five years.

The main cross-sold products were principal current accounts and credit cards (figure 1):

- Develop a mortgage specialised sales force - executives in nearly 60% of the banks surveyed reported that mortgage sales force specialisation is important, and most have already initiated the process. This specialization can be accomplished either by developing a specific sales force, or by implementing specialised call centres accessible both by customers (in addition to the Internet) and by the retail banking sales force (as an additional source of mortgage expertise).

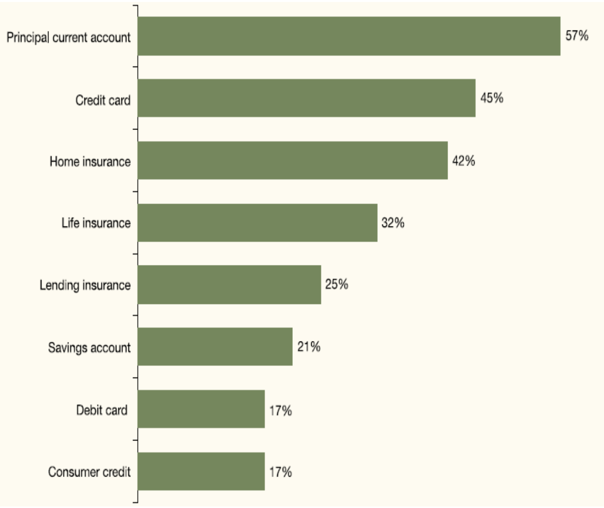

Figure 1. Main Cross-Sold Products (% Respondents)

Nevertheless, some banks surveyed reported that in today's context of crisis, investing in new sales forces, with its additional costs, might not be relevant.
- Intensify commercial management.

2. Developing innovative services is an activity seen by many respondents as less important for the coming years than it has been for the past years, but it still remains a key opportunity in 38% of the banks interviewed.

To capitalise on this opportunity, retail banks are focusing on three areas:
- Develop non-financial services related to mortgage - was viewed as an important activity in nearly half the banks interviewed, with the objective of generating new revenues with higher margins than those offered by mortgages.
- Create convergence/packages with consumer finance - bank executives interviewed cited consumer finance, as well as payment cards and insurance, as key products for packaging.
- Innovate mortgage services - is not considered to be as important as it has been for the past five years. Most retail banks believe that existing services respond to their customer needs.

Yet some innovation will be done by simplifying or customising existing services, for example by increasing their flexibility (loan maturity, repayment policy, etc). Additionally, innovation will be used for niche products ("senior" mortgages, for instance).

3. Using remote channels (such as the Internet and call centres) - was the sixth opportunity overall, mentioned by 36% of the banks surveyed. Remote channels are used today principally as information channels in the mortgage sales process.

Sales through remote channels accounted for only 3% of mortgage sales in the banks surveyed (figure 2):

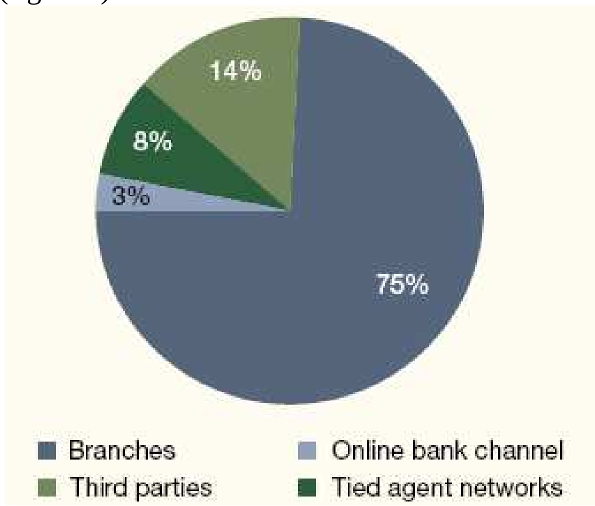

Figure 2. Mortgage Distribution Channels (% of Total Sales)

Strategies of capitalising on this opportunity:
- Position remote channels as pre-sales channels for branches - executives in more than half of the retail banks surveyed aim to develop remote channels as pre-sales channels for branches, for identifying, selecting customers, and understanding their needs. But the sale itself would take place at the branch level, so that the bank could capitalise on the customer relationship at a key commercial moment.
- Position remote channels as sales channels - nearly 40% of banks intend to develop remote channels as complementary sales channels to branches. The goal is to sell 5%-10% of products through the Internet or call centres, which will be linked to the introduction of simplified offers.

4. Pricing and Risk Management - is the second opportunity overall, and respondents in over half the banks surveyed cited this area as one of their top six opportunities over the next five years.

Three primary actions for maximising the benefits of this opportunity:
- Use customer-based pricing - will be developed by successful retail banks, while improving customer selection. Many banks already price their mortgage products using a mix of practices, including interest margin-based pricing, competition-based pricing, and customer-based pricing. Nearly 70% of respondents consider customer-based pricing increasingly important in the context of Basel II, the capital squeeze, and increasing client risk.

- Improve customer selection processes and tools - was cited as a primary lever in two-thirds of the banks surveyed, and credit risk management/monitoring (such as probability of default, loss given default and internal ratings-based approach) was viewed as essential by half of them.
- Enhance approaches to loan portfolio monitoring is also considered important. New challenges for retail banks are represented by the rising cost of risk, combined with greater difficulty in externalising risk through securitisation.

Banks need to develop early-warning and watch-portfolio approaches to identify risky loans before they become non-performing or to appeal to specialised institutions for it.

5. Origination and servicing optimisation - is the third opportunity overall, cited in 45% of the banks. By focusing on each part of the mortgage value chain, the origination process was divided into four parts: product design, risk management, underwriting, and granting/cash transfer and the servicing process - into three parts: after-sales management, recovery, and litigation (figure 3):

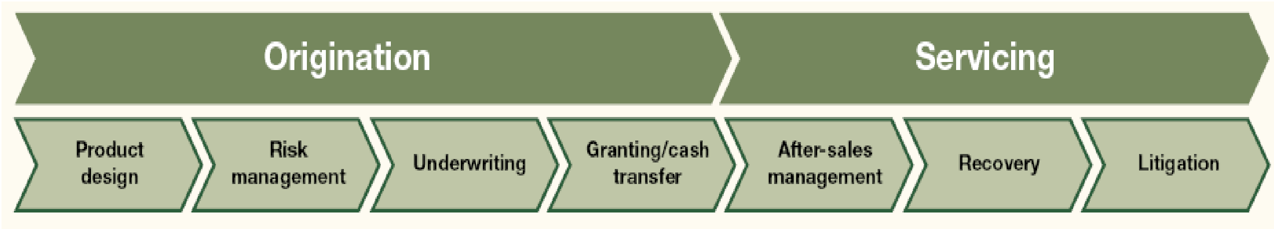

Figure 3. Mortgage Origination and Servicing Value Chain

61% of surveyed banks considered the acceleration of the origination process as a major challenge. They believe the capacity to make a loan quickly (e.g. two days) is a key success factor for sales.

Actions to reduce operating costs and lower the breakeven point through organisation structure: geographic consolidation (for IT optimisation - almost one out of every ten banks aims to develop multi-country middle and back offices over the next five years), synergies with other actors (either by sharing tools or even origination and servicing platforms, including human resources), offshoring, and outsourcing (by overcoming regulation and social-political barriers).

6. IT optimisation - is often a prerequisite for optimising origination and servicing, especially when considering organisation restructuring. More than one-third of banks surveyed considered the optimisation of their IT on a geographic basis as critical [4].

5. Conclusions

We strongly believe that the future financial system will involve a combination of traditional on-balance-sheet credit intermediation and securitised intermediation. An immediate market response to the crisis and better regulation will help in overcoming the actual financial crisis.

The securitised originate and distribute model should play an important role in national and global credit intermediation.

Financial innovation has to be organized so that it does not "transform" illiquid and risky instruments into apparently safe and liquid assets.

In the next years, only through a well coordinated marketing strategy, banks can gain the trust they need for leading a successful activity.

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