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PAYMENT SERVICES FOR EUROPE

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European Trend Survey

Banks & Future 2008

Special edition including a survey on the European payments market

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A stylized, light gray map of Europe is positioned behind the text of the Innovationsforum logo.

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Table of Contents

Table of Contents	I
Figures	II
Abbreviations	III
1 Introduction	1
2 About the study	2
2.1 Structure of the European Trend Survey »Banks & Future« 2008	2
2.2 Facts about the Study	2
3 Trends in the European Banking Sector	4
3.1 Strategic Challenges	4
3.2 Strategic Projects	6
4 Sales Management	7
4.1 Challenges.....	7
4.2 Branch Renewal.....	9
4.3 Direct Sales.....	11
5 Industrialisation of the Banking Sector	13
5.1 Banking Industrialisation	13
5.2 Status Quo of Banking Industrialisation.....	13
5.3 Objectives.....	14
5.4 Activities in the Field of Banking Industrialisation	15
5.5 Industrialisation Potentials	17
5.6 Barriers in the Process	18
5.7 Findings.....	19
6 Information Technology at Banks	20
6.1 Challenges.....	20
6.2 Investments in Information and Communication Infrastructure.....	21
6.3 Investments in Internet Services	22
7 Outlook for 2015	24
7.1 Assessments of the Banking Market in 2015.....	24
7.2 Assessments of Banking in 2015	25
7.3 Ready for the Future?	27
8 Conclusion	28
9 European Payments Market	30
9.1 Trends and challenges in the payments market	30
9.2 Payment Processing	32
9.3 Card Processing	34
9.4 Payment Innovations.....	35
Sources and References	36

Figures

Figure 1: Structure of the European Trend Survey »Banks & Future 2008.....	2
Figure 2: Participants in the European Survey.....	2
Figure 3: Group of Participants (Positions within the Bank).....	3
Figure 4: Competition is Intensifying (Selected Challenges 2007-2008).....	4
Figure 5: Strategic Challenges 2008.....	4
Figure 6: Strategic Projects (Yesterday, Today & Tomorrow).....	6
Figure 7: Challenges in Sales Management.....	7
Figure 8: Aspects of Branch Renewal.....	9
Figure 9: Community Banking at the Fraunhofer Showcase.....	10
Figure 10: Focus Areas for Investments at Branches.....	10
Figure 11: Focus Areas for Investments in Direct Sales.....	11
Figure 12: Achievements Due to Industrialisation.....	13
Figure 13: Objectives of Industrialisation Activities.....	14
Figure 14: High-Priority Business Areas for Banking Industrialisation.....	15
Figure 15: Expected Industrialisation Potentials (Areas).....	17
Figure 16: Identified Barriers in Banking Industrialisation.....	18
Figure 17: Challenges in IT management.....	20
Figure 18: Investments in IT solutions.....	21
Figure 19: Internet Solutions in Banks.....	22
Figure 20: Use of Web 2.0 Technologies in Banks.....	23
Figure 21: Assessments of the Banking Market in 2015.....	24
Figure 22: Assessments of banking in 2015.....	25
Figure 23: Are Banks Prepared for Future Challenges?.....	27
Figure 24: Main Challenges in the Payments Business in 2008.....	30
Figure 25: First Movers to use SEPA Products in the Next 3 Years.....	31
Figure 26: Establishing Reach for Payment Transactions in Europe.....	32
Figure 27: Top Criteria for the Selection of a Payment Services Provider in 2009 and later.....	33
Figure 28: Banks Considering Becoming an Acquirer.....	34
Figure 29: Payment Innovations.....	35

Abbreviations

ACH	Automated Clearing House
AOS	Additional Optional Services
ATM	Automated Teller Machine
BIC	Bank Identifier Code
CRM	Customer Relationship Management
EBA	Euro Banking Association
ECB	European Central Bank
EU	The European Union
IAO	Fraunhofer Institute for Industrial Engineering IAO, Germany
IBAN	International Bank Account Number
IP	Internet Protocol
IT	Information Technology
LAN	Local Area Network
MIFID	Markets in Financial Instruments Directive
N	Number of Respondents
PEACH	Pan European Automated Clearing House
POS	Point of Sale
PSD	Payment Services Directive
RFID	Radio Frequency Identification
SCF	SEPA Cards Framework
SEPA	Single Euro Payments Area
SMEs	Small And Medium-Sized Enterprises
SOA	Service Oriented Architecture
WLAN	Wireless Local Area Network

1 Introduction

Within the innovation forum »Banks & Future« numerous banks and IT service companies pool their competences under the scientific lead of Fraunhofer Institute for Industrial Engineering IAO with regard to future trends in the banking sector. Their objectives are to conjointly identify market potentials and structural and technical optimisation potentials, as well as bringing together users and producers of technologies in the banking sector, and initiating the necessary innovation processes.

In 2004, Fraunhofer IAO established an annual trend survey for the German banking market, called »Bank & Zukunft« (»Banks & Future«).¹ The survey addresses bank managers at banks of various sizes in a variety of banking sectors. The survey is based on research results from the Banks & Future innovation forum. In turn, the empirical results provide the basis for further research by the Forum.

In 2007, the Fraunhofer IAO trend survey was extended to the European level under the name European Trend Survey »Banks & Future«.² The European study addresses bank managers from different European countries. It reflects challenges and strategies at the highest level, for instance:

- Analysis of the European banking market
- Overview of current bank strategies
- Challenges in sales management and focal points of investments (branch design, information technology, human resources)
- Maturity of process management and innovation management
- Picture of the banking markets and banking in the year 2015
- Basis for further research in the innovation forum

The following summary provides a brief and informative overview of the study's principal findings.

¹ Spath (Editor) et al. (2005 / 2006 / 2007 / 2008).

² Engstler et al. (2007).

2 About the study

2.1 Structure of the European Trend Survey »Banks & Future« 2008

The European Trend Survey consists of five chapters (see Figure 1). In the first chapter, »Trends in the European Banking Sector«, the study highlights the trends and challenges that banks are facing now and will face in the future. In addition, the banks specify which strategic projects they adopt to deal with these developments. The chapter »Innovations in Financial Sales« details the challenges in sales management in general and provides an overview of investments at branches, as well as in direct sales channels. The chapter entitled »Industrialisation of the Financial Sector« reflects the maturity of banks in the process of industrialisation, as well as focal points in process management and innovation management. The »Information Technology at Banks« chapter outlines the IT solutions banks are investing in and the challenges they face if IT is to become a strategic competitive asset. Finally, the study paints a picture of banks in 2015 (»Outlook 2015«), based on the view of the respondents from their current vantage points.



Figure 1: Structure of the European Trend Survey »Banks & Future 2008

2.2 Facts about the Study

The survey period of the study was from November 2007 to February 2008. Fraunhofer IAO opted for a questionnaire and an online poll. The study contains responses from banks in twelve European countries with a total of 546 participants that were weighted per country (see Figure 2).

European country	Number of participants	Weighting percentage*
Austria	15	3.3%
Belgium	7	4.0%
Finland	4	2.1%
France	4	22.9%
Germany	483	24.7%
Great Britain	2	23.6%
Luxembourg	1	0.4%
Netherlands	6	6.7%
Norway	1	3.2%
Poland	12	3.3%
Portugal	2	2.0%
Switzerland	9	3.9%
Total	546	100 %

* Weighting based on gross domestic product of these countries in the year 2005

Figure 2: Participants in the European Survey

The group of participants encompassed all banking categories, namely commercial banks & specialised banks (58 percent), cooperative banks (35 percent) and savings banks (7 percent).

The majority of the banks polled (64 percent) had total assets of more than €10 billion. Banks with balance sheet totals of between €1 billion and €10 billion represented 13 percent, while banks with balance sheet totals of between €500 million and €1 billion represented 5 percent of the total. A further 18 percent had balance sheet totals of less than €500 million.

Approximately 70 percent of the banks polled had more than 1,000 staff, while 17 percent had between 100 and 1,000, and 13 percent had a workforce of less than 100 people.

Approximately 20 percent of the participants were members of the Executive Board of the bank, while 27 percent were executive managers of a non-sales department, and 5 percent were executive sales managers. Other participants (48 percent) were managers in different business sectors (e. g. operations, IT, sales) and members of strategic management teams of the bank.

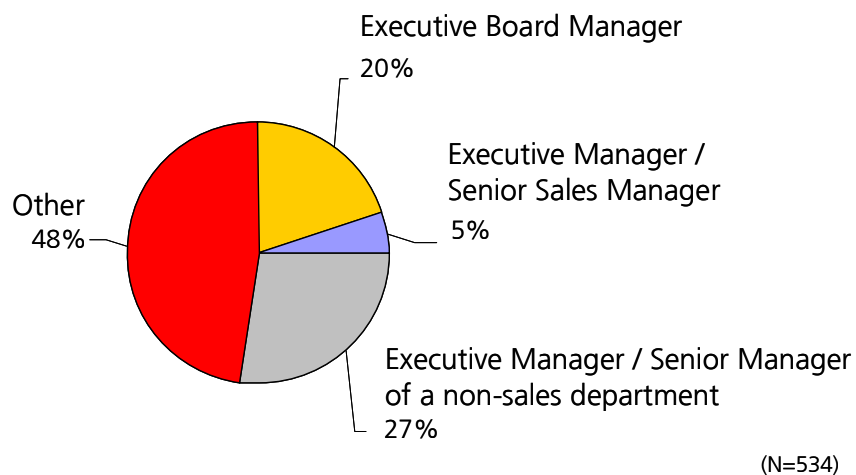


Figure 3: Group of Participants (Positions within the Bank)

Acknowledgements

The authors would like to thank all participants in the survey and all project partners from the innovation forum »Banks & Future«.

3 Trends in the European Banking Sector

3.1 Strategic Challenges

Competition in the European banking market is intensifying (see Figure 4). Competition is also expanding to the field of non-banks and to an European level with new competitors entering domestic financial markets.

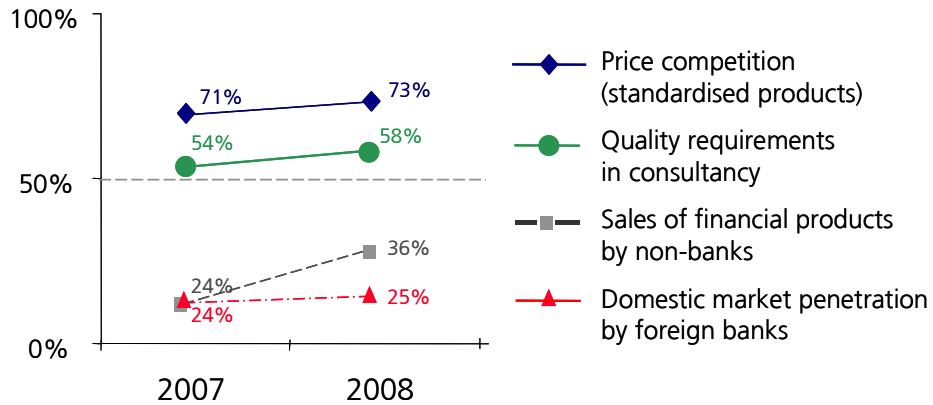


Figure 4: Competition is Intensifying (Selected Challenges 2007-2008)³

Price Competition

According to 73 percent of the respondents, the principal challenge is price competition between standard products (see Figure 5). Regional comparisons reveal that price sensitivity is particularly high in Germany, where 96 percent of banks attach great importance to it.⁴



Figure 5: Strategic Challenges 2008

³ European Retail Banking Survey 2007, see Engstler et al. (2007), p. 4.

⁴ See Spath (Editor) et al. (2008), pp. 7-8.

Share of Wallet as a Result of Better-Informed Customers

An increasing amount of financial business is being handled by multiple banks (share of wallet). Customers are better informed than ever before and expect high quality at competitive prices. It is the customer who decides and they specifically select the best of breed. This is why customer retention is becoming an ever-more crucial success factor in the banking industry.

Towards two Types of Modern Banking

Traditional banking methods are a thing of the past. Banks have to cope with two major business models that are both required by the customer:

Type 1: No-Frills Banking – Highly Automated, Reduced to Essential Functionality

Simple banking services are regarded as a commodity. Consequently, customers can manage them on their own using modern technologies such as the internet or ATMs. Bank automation is accepted by the customer and enables simple services at low costs.

Type 2: Life Assistance Banking – High Quality, Considering Soft Factors

Customers expect high-quality individual banking services and advice from their bank in all respects when it comes to 'life assistance banking', which includes the consideration of soft factors, as well as individual solutions that meet customer needs. Customer interaction should be based on individual consulting and should not consist solely of a standard interview that only benefits the financial consultant. This ensures that consultancy and advice is a valuable service – even when supplementary to a specific sales process. Banks therefore have to focus on customer orientation and a high quality of service without losing control of operational process costs.

The European Dimension of Banking

In order to prepare for a harmonised European financial market, banks now have to cope with more European regulations. On the one hand, stricter regulatory requirements call for a high degree of flexibility of banks, while on the other hand banking is becoming less nationally focused, as an increasing number of foreign banks are entering domestic markets. Furthermore, customers compare the service offerings at European level.

Demand for Innovation

Besides price competition, other critical success factors such as service quality, added value, speed and the increasingly European view of the market will gain increasing significance. Banks have to define an innovation strategy to cope with these new requirements.

3.2 Strategic Projects

Banks respond to the wide range of challenges they face with an equally wide range of strategic projects (see Figure 6).

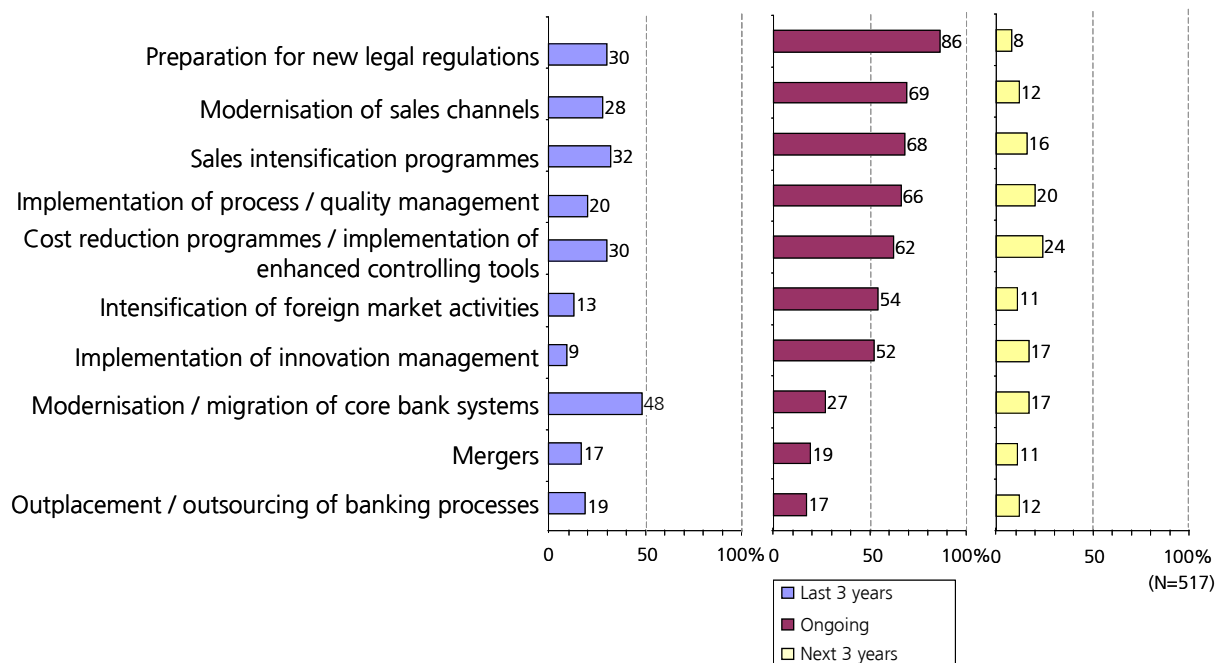


Figure 6: Strategic Projects (Yesterday, Today & Tomorrow)

Preparation for New Legal Regulations is a 'Must'

The task of preparing for new legal regulations is a top priority in ongoing strategic projects. However, bank managers expect that this peak of effort resulting from external regulations will decline in 2008.

Customer Interaction – a Major Field of Innovation

Innovation and sales management are identified as significant drivers for growth and income within a highly competitive market. Banks believe that sales potential among existing customers has not yet been exhausted and therefore aim to optimise their efforts. Consequently, bank managers ranked the modernisation of sales channels (69 percent) and programmes for sales intensification (68 percent) among the current top three strategic projects.

Process Management – Increasing Quality and Reducing Costs

Another objective is to improve organisational effectiveness and efficiency by means of process management and quality management (66 percent). Cost reduction – combined with the implementation of enhanced controlling tools (62 percent) – is seen as a supporting activity that will guarantee long-term economic success and provide the foundation for further investments in innovation.

In conclusion, the bank managers plan to renew the business models by means of innovation in sales and by optimising value chain processes.

4 Sales Management

4.1 Challenges

Innovation in sales involves a new design for the interaction of banks with their customers. Despite the trend towards face-to-face contact, the virtual branch has also gained relevance for customer interaction; while it has further development potential, a variety of requirements also need to be met to ensure it is used to its full potential.

Fighting for Customers

Looking at actual strategic projects in sales management (see Figure 7), customer retention and customer acquisition in target groups are becoming crucial success factors for banks. 77 percent of the bank managers polled consider this a top priority.

Banks invest in retaining customer loyalty to gain long-term profit. Furthermore, quick wins in new target groups must be transferred to a mid or long-term relationship to achieve the required return on investment in sales.

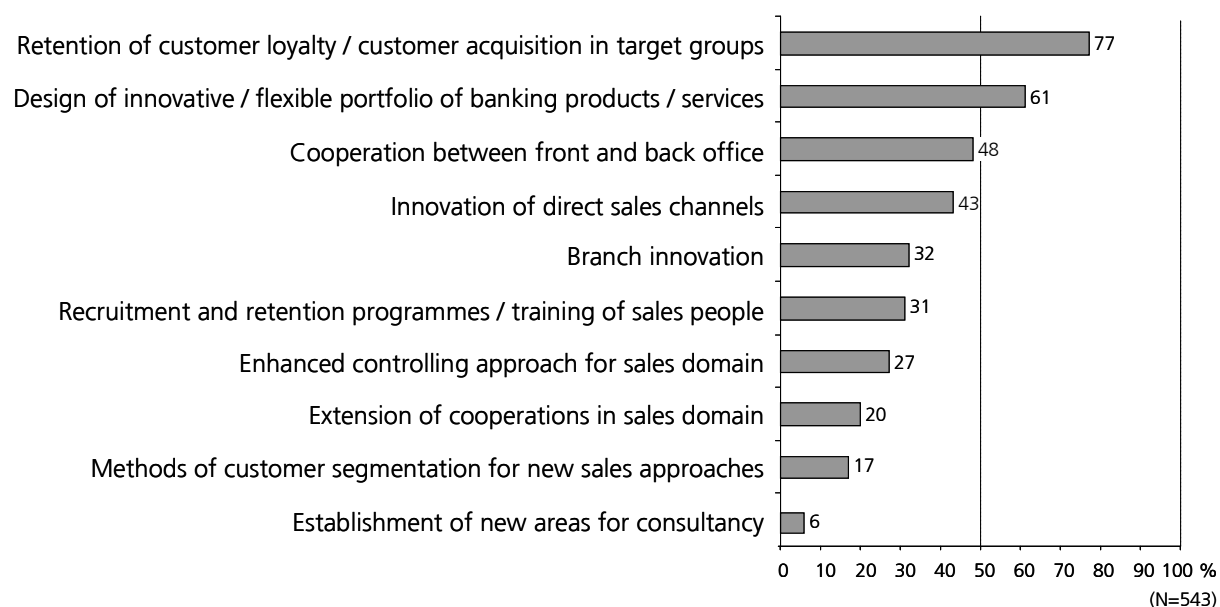


Figure 7: Challenges in Sales Management

Pushing Innovation – Reflecting Real Customer Needs

The European banks have stated that there is a growing demand for the design and configuration of innovative products and services (61 percent) in order to cope with changing customer needs. Innovation does not imply an increase in complexity and is focused on existing and future customer needs that generate economic benefits for the bank.

Supporting Sales Force

The reorganisation of the cooperation between the front and back office is seen as a means of boosting the sales power by the European bank managers by 48 percent. This covers the reorganisation of processes, roles and

structures within the sales domain, as well as the implementation of supporting information technologies such as solutions for end-to-end process support. This in turn ensures the highest possible level of support for both sales and customer processes.

Modernisation of Sales Channels

The banks assume that sales potential among existing customers has not yet been exhausted and therefore aim not only to intensify sales, but modernise sales channels. Innovation in sales demands an integrated comprehensive approach that considers all sales channels and their interrelationships. European banks rank innovation of direct sales channels (43 percent) with a higher priority than branch innovation (32 percent), where modernisation is a general requirement (see Chapter 4.2). The modernisation task requires an integrated view across all sales channels used by the customer in order to avoid a bank having two different faces (e. g. a modern bank in all channels).

Enforcing Sales Power – Management and Human Aspects

Staffing and retention programmes in the sales domain are an increasing management challenge for banks (31 percent). Key aspects include the increasing complexity of products and processes (e.g. as a result of regulations), better-informed customers and quality demands, the demand for flexibility and mobility in sales (e.g. opening hours, mobile sales), required technical know-how in banking (e. g. technology at the workplace, new devices for the customer such as the internet, smart card-based solutions, mobile payment solutions, etc.), and how to perform human resource management in a targeted and economic manner (e.g. implementing suitable strategic systems to measure and manage sales performance adequately).

4.2 Branch Renewal

Customers continue to seek personal contact with their bank counsellor, especially regarding complex financial matters that require detailed advice, or when signing contracts. The branch will therefore continue to be a major customer interface of banks.

But do changing customer requirements and further development of other sales channels still define a need for branches and further investments in this traditional channel?

Branch Modernisation as a General Requirement

Currently, over half of the banks participating in the survey (57 percent) plan to invest in the modernisation of all their branches (see Figure 8). As an initial channel within a multichannel strategy, the branch is a place for personal interaction. In addition, its outline defines the individual 'face' of the bank in the markets today. Its look and feel must have emotional appeal for customers without disregarding economic aspects.

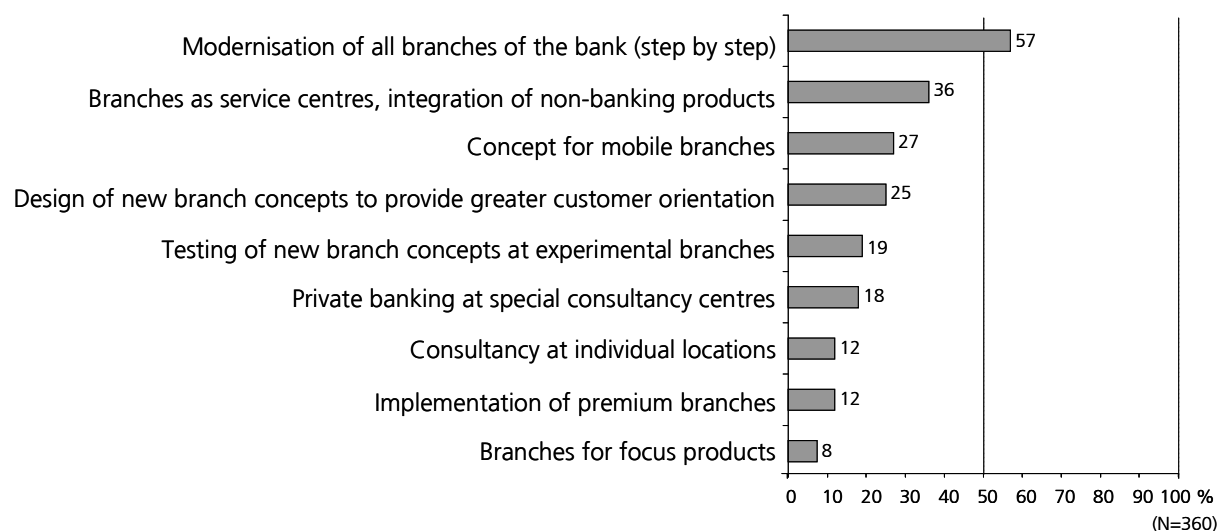


Figure 8: Aspects of Branch Renewal

More than Banking at the Branch

Branch modernisation does not focus solely on the modern architectural design of a building or its corporate design. 36 percent of bank managers voted for an enhanced definition of a branch as a place for communication and the sale of banking and non-banking products and services. It reflects the definition of innovative services and how they are offered at the branch, the outline of personal customer interaction, modern technological support where necessary and even the definition of initiators for personal contacts as a starting point for personal advice and sales.

A conceptual framework for this new type of a branch was defined in the scenario 'Community Banking' by Fraunhofer IAO (see Figure 9).⁵ In this scenario the branch is seen as a place for communication and interaction that

⁵ Source: Banks & Future Innovation Forum, Spath (Editor) et al. 2006, pp. 22-24. The scenario was first presented in a showcase at Fraunhofer IAO in Stuttgart in May 2007.

provides customers with banking and additional services (e.g. after-work banking at a bank café and supplementary services provided by the bank or cooperating partners). Communication areas and areas of privacy are combined in an open-space concept. Branches are open to both customers and non-customers.



Figure 9: Community Banking at the Fraunhofer Showcase

Focal Points of Investments at the Branch

The modernisation of branches is twofold, involving bank automation and enhanced individual service points (see Figure 10).

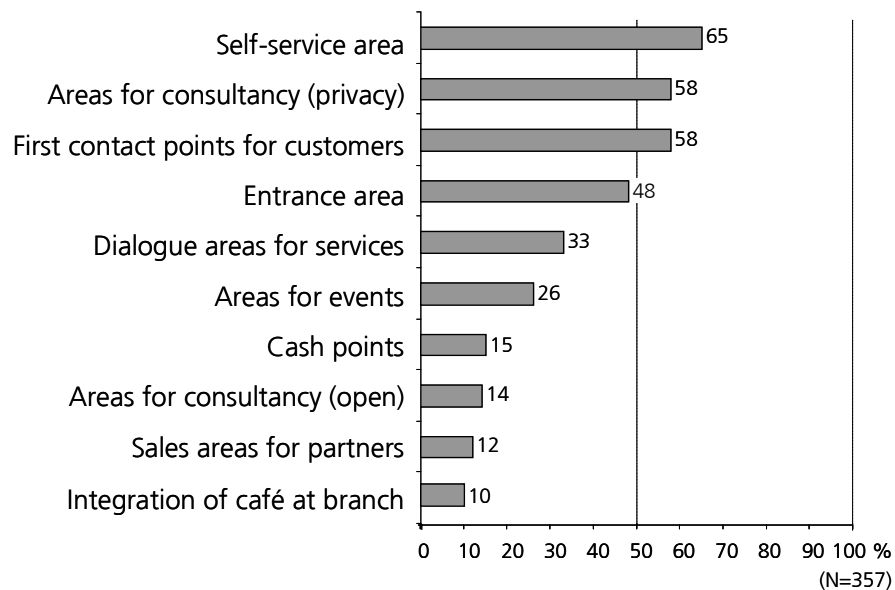


Figure 10: Focus Areas for Investments at Branches

Bank Automation and Integration of Value-Added Services

During recent years customers have been encouraged to use self-service terminals such as cash dispensers or simple service terminals in order to increase automation levels. Self-service areas were increasingly separated from the branch processes in order to enable 24-hour use. Banks now want to redesign these areas to make them an integral part of their branches and improve the service quality provided at these machines (65 percent). For example, CRM-based customer interactions at ATMs are seen as an

appropriate measure for integrating them into the branch processes. In addition, new services will be added, such as ticketing for external partners.

Face the Customer

Customer experience is a key factor at a branch and is twofold:

- It is the first impression at a branch that counts:
Banks plan to bridge the gap between the automated self-service area and the personal service and individual advisory areas. Consequently, the first contact points will be located close to the customer entrance and staffed with sales employees from the bank who will be able to assist the customers. In addition, service points will be installed for first-level support and as a central point of communication, from which customers can be directed to additional service points.
- Privacy for the customer during personal consultations:
Consultancy areas have been redesigned to increase customers' comfort during personal consultations with their bank counsellor. Privacy does not only encompass a private area, but also the design of actual communication processes, the soft skills of the consultant, the technologies used for quality assurance (reduced to a minimum) and a sense of well-being.

4.3 Direct Sales

Banking is now a multichannel business. For this reason, banks plan to modernise all sales channels to cope with changing customer needs and utilise enhanced technical opportunities.

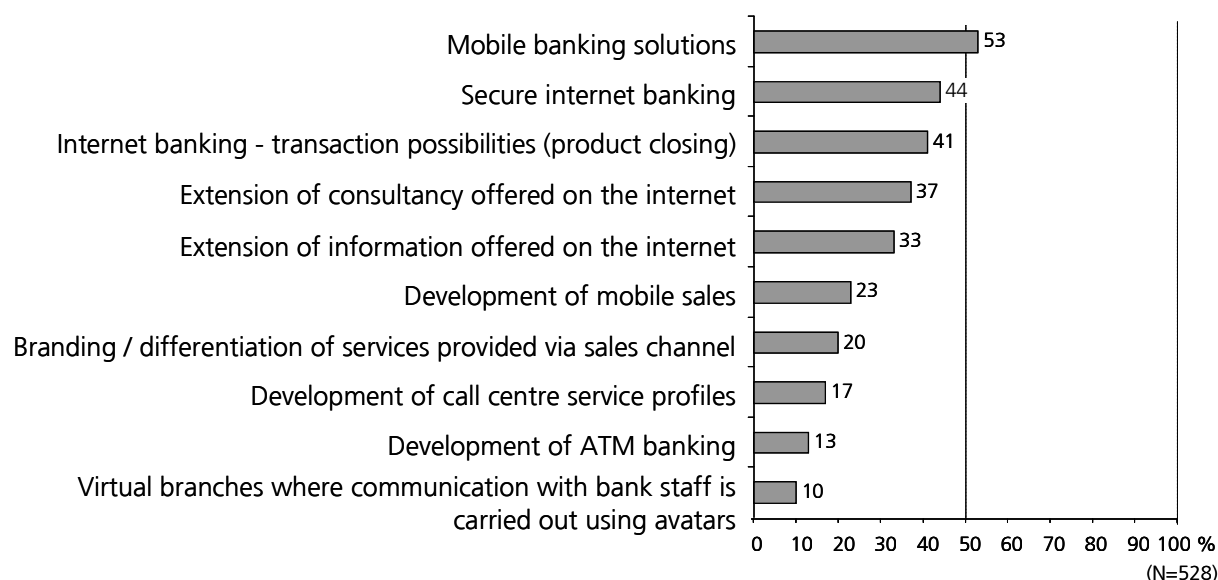


Figure 11: Focus Areas for Investments in Direct Sales

Mobile Banking: Driven by Technology or by Changing Customer Needs?

Mobile banking solutions are seen as an important trend in Europe (53 percent in total). However, the number of positive responses varies between

the different European countries (e.g. only 14 percent in Germany).⁶ The maturity of technologies, changing requirements of the customer and quality of services offered in this channel have to be managed to raise the channel to an economic level.

Internet Banking: Security Matters

Internet banking has become a standard channel in banking. Banks have to cope with new challenges such as cyber crime (44 percent) and also want to expand the services and information offered via the internet (see also chapter 6.3).

Sales Goes Mobile

Customers require greater flexibility from the bank and its contact points. As a result, investments in mobile sales will enable bank employees to meet customers' needs (23 percent) and ensure quality at any location. This includes the mobility to provide banking services on location at a customer's home or premises (77 percent) and the customer's preferred branch (46 percent).⁷

Virtual Branches

As a current investment, only 10 percent of the bank managers consider virtual branches viable. However, 52 percent consider this new channel important for the future (see Chapter 7.2).

⁶ Spath (Editor) et al. (2008), p. 20.

⁷ European Retail Banking Survey 2008: Additional question on where mobile sales will take place.

5 Industrialisation of the Banking Sector

In the European Banking Sector the term banking industrialisation is still relatively obscure. This chapter therefore provides a brief description of banking industrialisation, followed by the results of the actual market survey.

In the financial service sector, and in particular the area of banks, there is a high level of competition between banks and considerable pressure to improve organisational effectiveness, efficiency and customer orientation.⁸

5.1 Banking Industrialisation

In this context the term banking industrialisation describes the transfer of technological concepts and management processes from the industrial to the financial service sector. Industrialisation focuses on the capability of a bank to optimise the complete value chain by managing the vertical and horizontal integration of business partners, as well as implementing mature business process management within the organisation.⁹

Banking industrialisation therefore comprises a broad portfolio of different management topics and aspects that banks can use to optimise their organisational structures.

The following sections outline the results of the European Trend Survey »Banks & Future« 2008 and highlight the goals and expectations of banking industrialisation, as well as the expected economic benefits from a bank's perspective. Finally, the actual barriers and restrictions are explained, followed by a conclusion summarising the findings for banking industrialisation.

5.2 Status Quo of Banking Industrialisation

Despite the fact that the term industrialisation is not widely used in the banking industry, the management issues of banking industrialisation are not a completely new development in the banking sector. Most of the participating banks have experience in industrialising their processes.

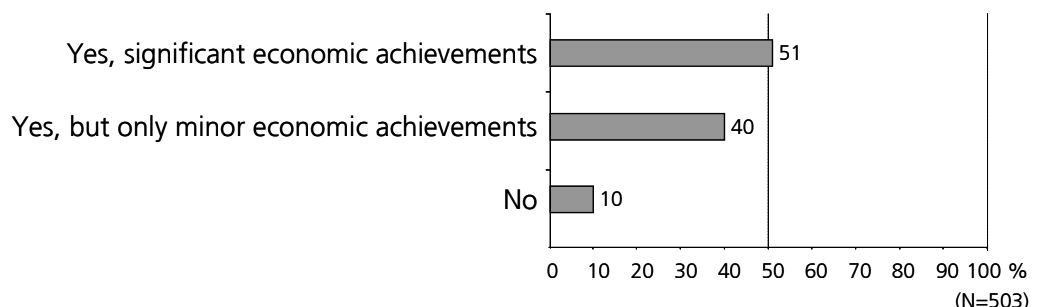


Figure 12: Achievements Due to Industrialisation

⁸ Spath (Editor) et al. (2007).

⁹ Praeg (2007).

As illustrated in Figure 12 most of the European banks have experience of industrialisation. In the actual survey, 51 percent of the banks stated that they achieved significant economic improvements as a result of the implementation of industrialisation methods. In addition, 40 percent of the participating banks stated that they achieved minor success by means of industrialisation, and only 10 percent of the participants stated that they had achieved no success in this area.

This shows that industrialisation is an important issue for almost every bank in Europe. It is therefore important to investigate the objectives that banks associate with industrialisation.

5.3 Objectives

A successful industrialisation strategy requires the definition of objectives and the pursued future status of the bank.



Figure 13: Objectives of Industrialisation Activities

Efficiency, Effectiveness and Quality

With regard to the results, the presumption is that the overall industrialisation maturity level in the European banking market can still be improved. The survey highlights that there is a definite lack of process efficiency at the majority of the European banks. In the event of industrialisation, 81 percent of the participants expect an increase in business process efficiency, while 65 percent of the participating banks wish to improve quality management in order to provide high-quality services and products. Furthermore, 58 percent of the banks expect an increased focus on banks' core competencies due to the integration of different partners in their respective value chains. 54 percent of the participating banks aspire to improve on organisational agility and flexibility in order to cope with changing markets.

Another objective for banks is to share the costs and risks of strategic investments. Due to the creation of value-added networks, the risks and costs can be shared by different partners.

Strategic Aspects of Industrialisation

A further goal focuses on the improvement of strategic planning and control processes within the bank. 48 percent of the participants considered this aspect as an important goal. For 46 percent of the banks, industrialisation measures must support banks in achieving a leadership position in innovation management.

Further targets include the preparation for the European financial market (39 percent), and a modified bank organisation structure (38 percent) and culture.

Key Findings

The results from the survey regarding the industrialisation targets show that banks have a conservative point of view in this respect. The improvement of process efficiency has been a high priority for many years. Overall, this indicates that the average industrialisation maturity level of European banks still requires improvement.

An important question is how the participating banks plan to achieve these goals. The following sections illustrate the industrialisation activities of the European banks.

5.4 Activities in the Field of Banking Industrialisation

This section illustrates the business activities involved in banking industrialisation, showing the high-priority activities that banks plan to pursue to achieve the goals mentioned in the previous sections.

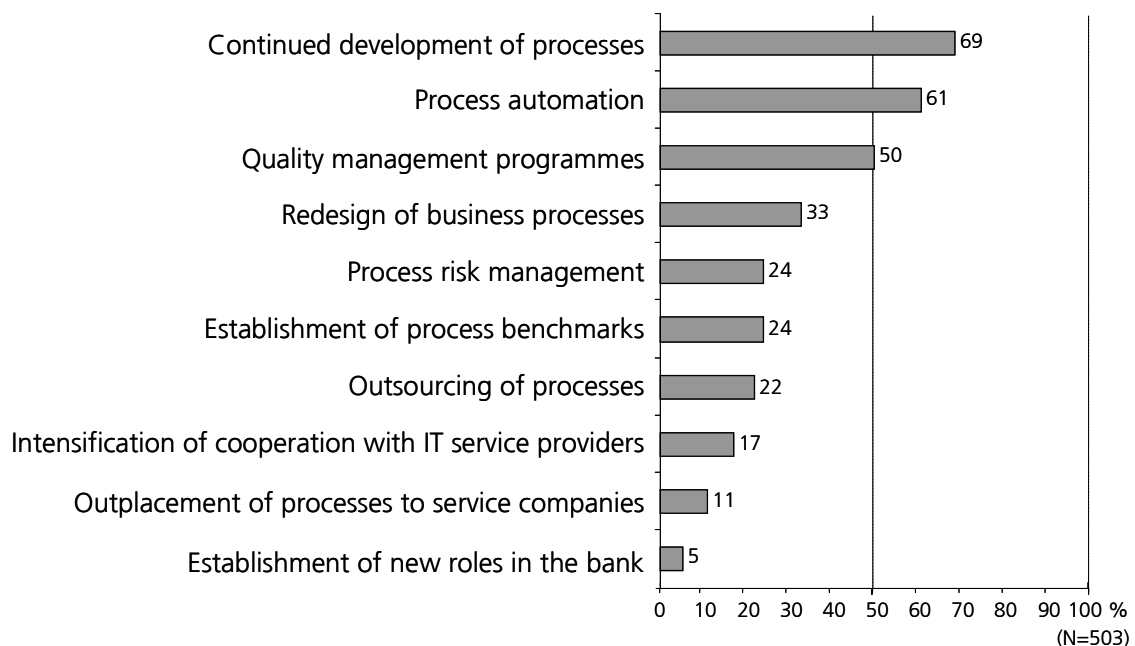


Figure 14: High-Priority Business Areas for Banking Industrialisation

Business Process Management

Figure 14 shows that the activities in the field of bank industrialisation are also focused on the increased professionalisation of business process management and the process quality management. 69 percent of the participants considered the further development of processes an important activity, followed by process automation (61 percent). The implementation of quality management programmes is an important business activity for 50 percent of the participating banks, while 33 percent of the banks have a strong interest in the re-engineering of existing processes.

These results show that the overall process maturity level at European banks is medium. Banks are improving their processes and the level of process automation, as well as trying to improve the quality of the business processes.

Further Activities

Other activities are focusing on the implementation of a risk management process (24 percent) and the establishment of benchmarks for implemented business processes. The assumption is that banks that focus on these aspects have a higher industrialisation maturity level because these topics are more advanced than previous topics.

For 22 percent of the European banks, outsourcing of business processes and the cooperation with external IT service providers (17 percent) have a high priority. Furthermore, the outplacement of processes is on the agenda of 11 percent of the participants and only 5 percent of the banks plan to implement new organisational roles within the bank.

Key Findings

In summary, the results show that the majority of the European banks are actually working on the professionalisation of their business process management and quality management within the bank.

It is therefore important to identify business areas in which European banks see further business potential for industrialisation.

5.5 Industrialisation Potentials

After analysing the actual focus of industrialisation activities, it is important that an evaluation is performed based on the business areas in which banks see further potential for banking industrialisation.

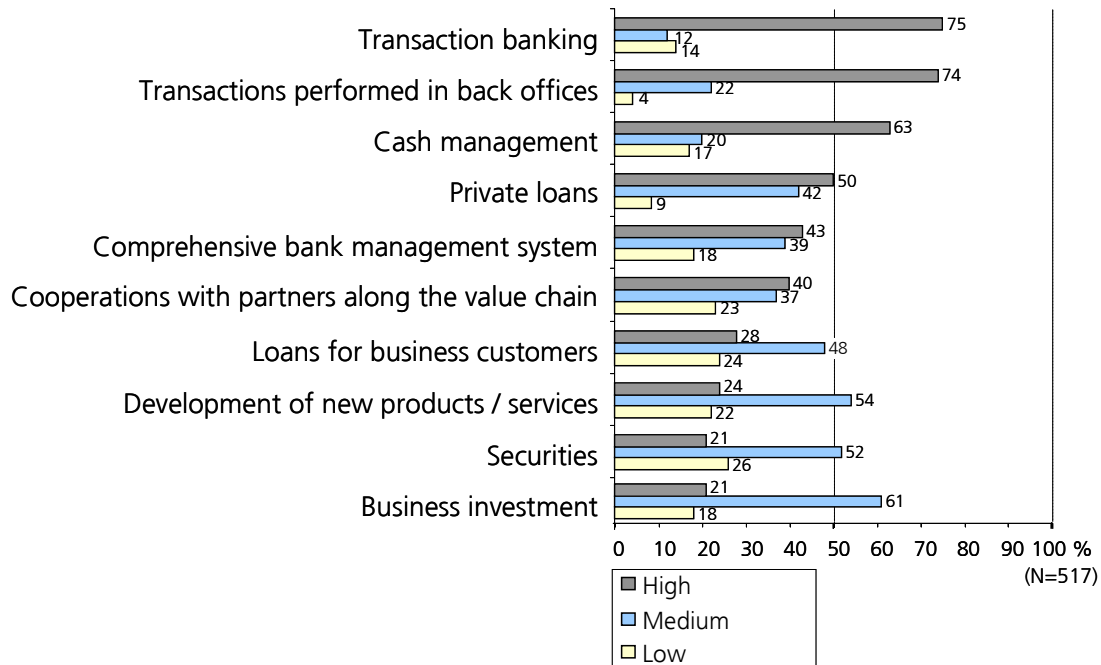


Figure 15: Expected Industrialisation Potentials (Areas)

Potentials in Structured Processes

From the point of view of the participating banks, the highest industrialisation potential lies in the area of transaction banking, where 75 percent of the banks estimate a high industrialisation potential, followed by back office transactions (74 percent). These results underline the assumption that the overall industrialisation maturity level is low to medium.

A further business area that banks believe has high industrialisation potential is cash management (63 percent), followed by business processes dealing with private loans (50 percent). 43 percent of the banks selected the internal management processes of banks, while 40 percent of the banks believe the interorganisational processes between banks and external service partners have high industrialisation potential. Only 24 percent of the European banks see high industrialisation potential in the development of new products and services.

Banks also believe that business areas and processes with highly standardised workflows have high industrialisation potential.

After identifying business areas with a high industrialisation priority and industrialisation potential, it is important to analyse which barriers European banks see in the industrialisation process.

5.6 Barriers in the Process

The analysis of the barriers in bank industrialisation is of considerable importance to both practitioners and scientists. Therefore, the final aspect of bank industrialisation is focusing on the existing barriers.

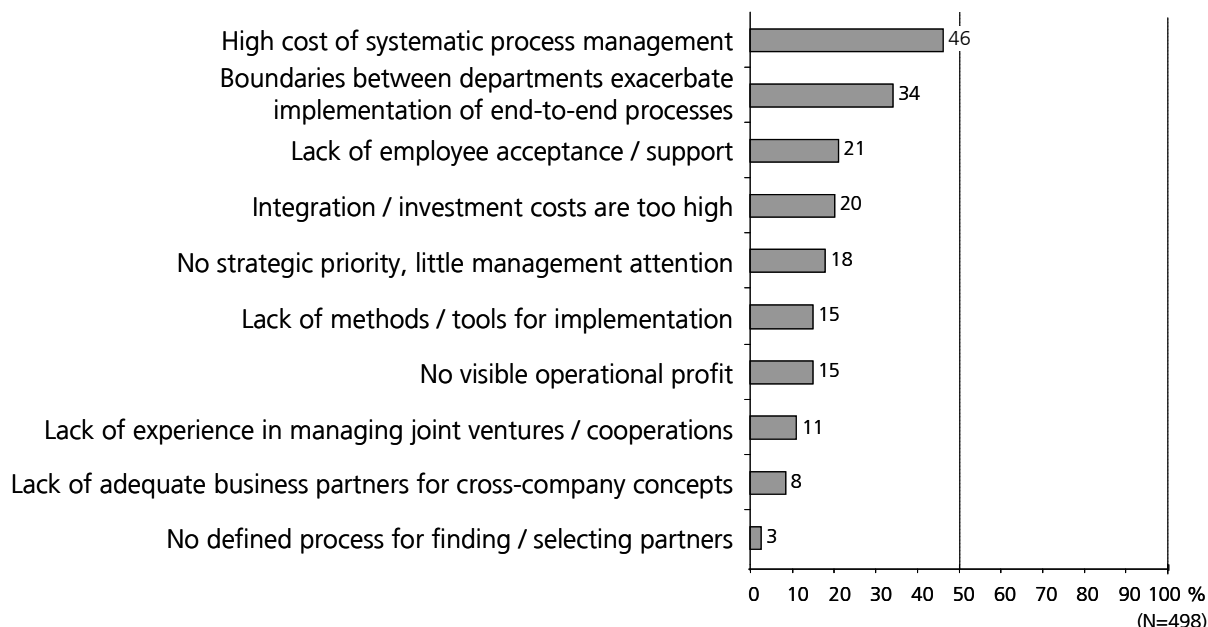


Figure 16: Identified Barriers in Banking Industrialisation

Barriers: Costs, Organisation and Acceptance

The results of the European Trend Survey 2008 show that the cost of implementing professional business process management is an important barrier with respect to bank industrialisation. 46 percent of the participating European banks ranked this aspect as the main reason (42 percent in 2007). In contrast to the results for 2007, the organisational boundaries between departments are important barriers for 34 percent of the European banks. In 2007, 50 percent of the participants considered this point the main barrier.

Ranked third, banks consider the lack of acceptance of industrialisation measures among their staff an important barrier (21 percent), followed by high investments and integration costs of industrialisation activities (20 percent).

For 18 percent of the participating banks, industrialisation does not have strategic priority and is actually outside the scope of the management. Further barriers include the lack of suitable methods and instruments (15 percent) and the assumption of missing operational profits (15 percent) from industrialisation activities.

Other barriers include the lack of experience and competences in managing value-added cooperations (11 percent) and a lack of suitable business partners for interorganisational business processes (8 percent). 3 percent of all participants mentioned the lack of a process for finding suitable partners as an important organisational barrier with respect to banking industrialisation.

5.7 Findings

The results of the European Trend Survey with regard to industrialisation show that it is an import issue for the participating European banks. In the field of banking industrialisation there are three main issues that are highly relevant for banks all over Europe.

Efficiency, Effectiveness and Quality

Increasing the efficiency of banking organisations and their business processes is the first area of interest. The results of the European Trend Surveys in 2007 and 2008 show that this is the top priority for banks in terms of industrialisation. The second issue focuses on effectiveness and the alignment of all business and IT activities to the banks' strategies, while the third focuses on quality management. This includes overall organisational quality management, as well as the implementation of business process quality management.

Suitable Methods

The survey also shows that industrialisation is a suitable method by means of which banks can improve their organisational performance and confirms the three aforementioned top issues. In this context banks are increasingly accepting the transformation of industrial methods and instruments for the financial services sector as an opportunity to improve business performance and efficiency.

Industrialisation Maturity Level

Nevertheless, the results also show that the actual maturity level of banking industrialisation is still low to medium. Hence there are many open issues in relation to which banks must increase their industrialisation maturity levels and improve their efficiency, effectiveness, service and business process quality.

6 Information Technology at Banks

6.1 Challenges

The increasing complexity of the banking business and new challenges in sales and process management require the implementation of information technologies (IT) that boost process performance and support innovation in banking business.

Focus on Cost Reduction

82 percent of the respondents considered the reduction of IT costs the key challenge in IT management in 2008 (see Figure 17). As a result of the increasing number of European regulations being implemented and operated by banks, there is only a limited budget for pushing innovative solutions such as new Web 2.0 technologies.

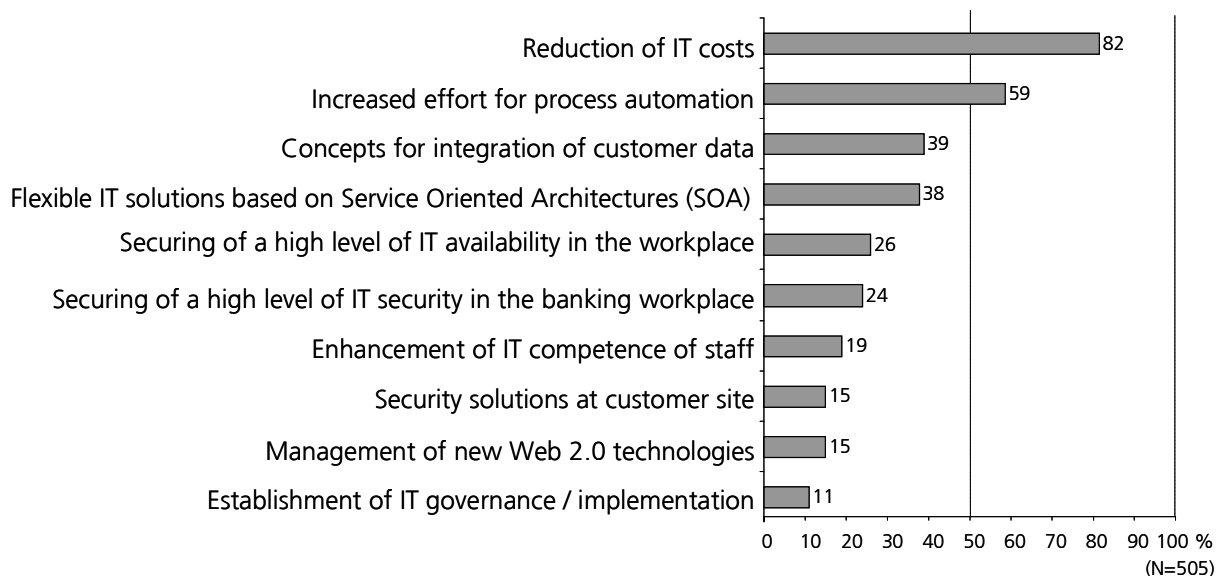


Figure 17: Challenges in IT management

Process Automation: Quality, Speed and Cost Reduction

IT is seen as a key enabler for boosting process performance in banks. Approximately 59 percent of the banks plan to invest in workflow and document management systems for process automation in their back offices. In order to boost process performance in front offices, the respondents plan to invest in concepts for the integration of customer data (39 percent).

Flexibility Powered by SOA

Increasing demands for flexibility and agility by the markets demand IT infrastructures that face changing requirements and enable banks to adapt processes and supporting tools in the bankers' workplace. New concepts such as Service Oriented Architectures (SOA) will provide the flexibility required for IT systems to perform business processes within banks and across borders.

6.2 Investments in Information and Communication Infrastructure

The European Trend Survey shows that banks are investing in new basic infrastructures such as IP-based communication and IT solutions for mobile consultants (see Figure 18). There is still reservation regarding the use of innovative information and communication infrastructures to interact with the customer.

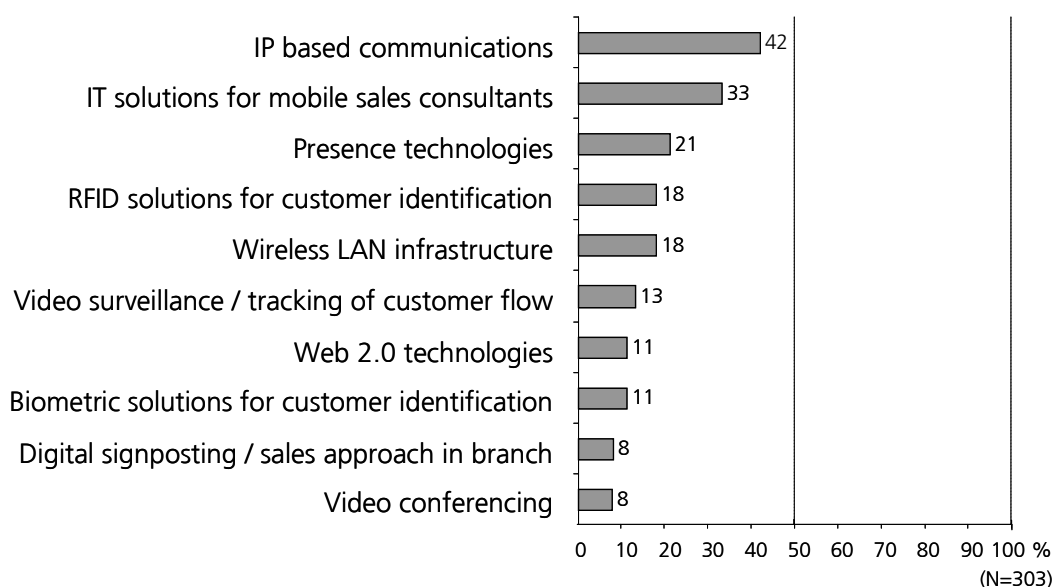


Figure 18: Investments in IT solutions

Modernisation of Communications Infrastructure

Banks are modernising their communication infrastructures in order to gain flexibility and facilitate value-added services by using integrated networks. Technologies such as IP communication are of increasing importance (42 percent versus 23 percent in the 2007 survey¹⁰). Banks are also investing in IT solutions for mobile sales consultants (33 percent) in order to optimise process handling and sales performance at locations where personal advice is provided. 18 percent of the banks plan to install wireless networks in their branches.

Security and Service

Security solutions such as RFID, biometric identification or video surveillance deliver valuable general information on customer flow, which can be used to optimise branch processes, etc. In addition, these solutions enable customers to be addressed individually by connecting the information with a CRM database.

Experimentation with New Technologies

Innovative communication media such as presence technologies (21 percent) or video conferencing systems (8 percent) are regarded as additional services at a branch that can be used to integrate experts wherever they are required. Innovative presentation media such as digital signposting, which are powered by a media content database enabling flexible information presentation on

¹⁰ Engstler et al. (2007), pp. 14-15.

demand, are only regarded as additional media and do not currently have a high priority.

6.3 Investments in Internet Services

Internet technologies currently serve as a basis for internal and external information and communications in the banking sector. But are banks adopting the next generation of internet technologies such as Web 2.0 technologies?

Internet for Information Only

The internet is an important information channel to the market that is used by almost all customers. Consequently, 78 percent of the banks are focusing on information services for customers (see Figure 19). Internet-based solutions have also been established for internal communications and knowledge transfer within the bank (68 percent). The increasing importance of this channel for internal and external users requires the implementation of modern security concepts.

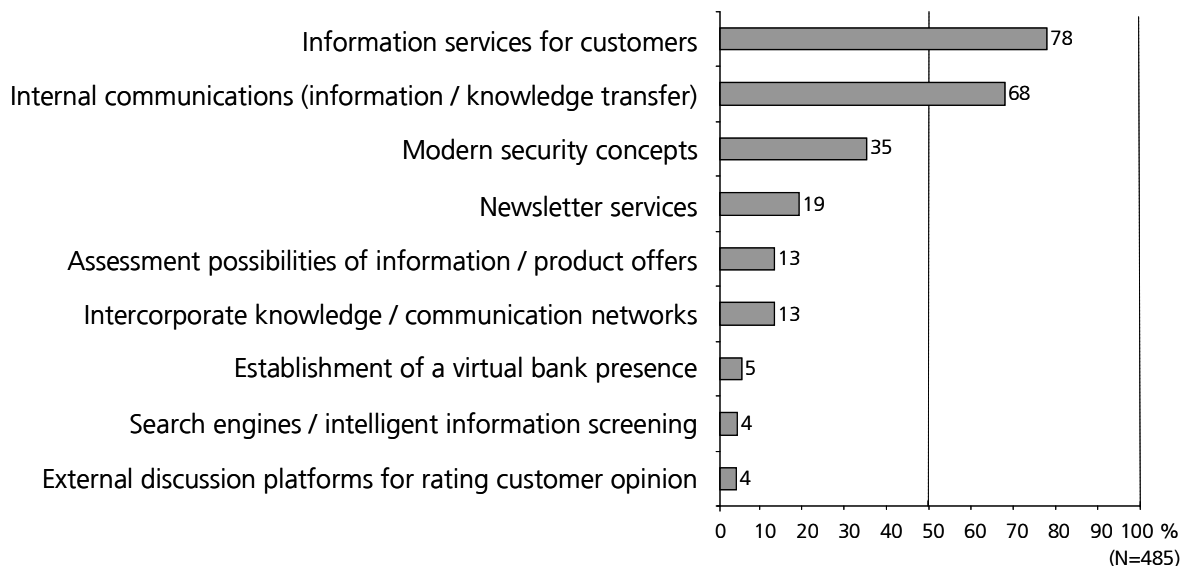


Figure 19: Internet Solutions in Banks

Lack of Experience Using New Internet Technologies such as Web 2.0 Services

Additional and new services such as newsletter services, discussion platforms, intelligent information screening etc. were deemed to be of little relevance. Approximately 66 percent of the banks in Europe do not currently use Web 2.0 technologies (see Figure 20). This lack of experience of external and internal use will be one of the primary issues facing banks.

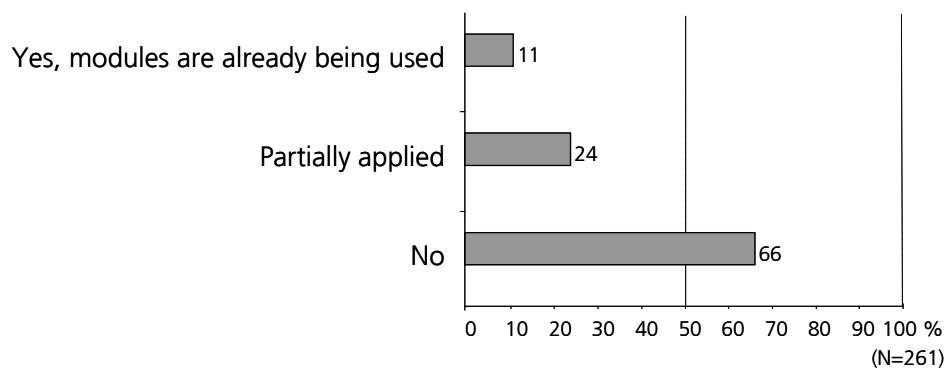


Figure 20: Use of Web 2.0 Technologies in Banks

7 Outlook for 2015

Following the identification of actual market trends and developments, this part of the European Trend Survey focuses on the future developments and provides an outlook on the future banking market and future banking in 2015 as perceived by the participating bank managers. This chapter is concluded with the issue of the future readiness of banks.

7.1 Assessments of the Banking Market in 2015

The assessment of the future situation on the 2015 banking market shows an increased integration of the European banking market. The market integration will be supported due to the increased implementation of harmonised laws and regulations in the European banking market. This development is underlined by the survey results.

Nevertheless, the increase in market integration will lead to increased competition in the European banking market. As illustrated in Figure 21, foreign service providers will have significant market shares in national banking markets by 2015. 50 percent of the participants consider this development highly relevant. Another aspect of this issue is the implementation of cross-border cooperations in the future banking market. 49 percent of the banks believe that this will be standard practice in the 2015 banking market. With the increased market competition the number of banks will be reduced due to mergers and acquisitions (46 percent).

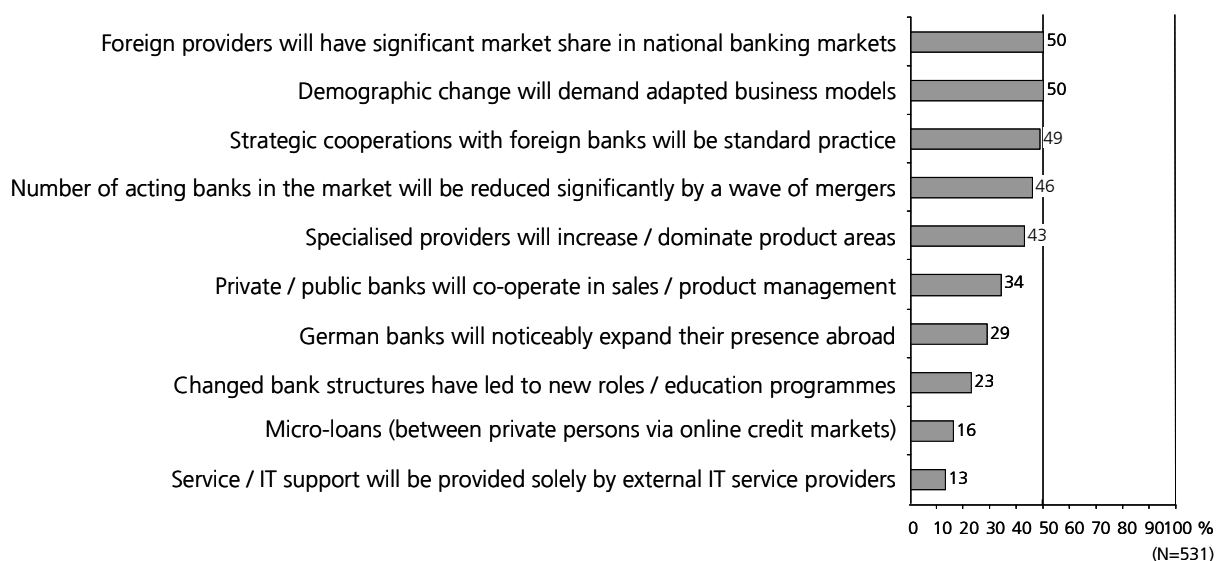


Figure 21: Assessments of the Banking Market in 2015

Furthermore, the future market competition will be expanded from the banks to the bank-related service providers. 43 percent of the participating banks predict that specialised service providers will control different product areas. A further 34 percent of the survey participants expect an increased number of cooperations between public and private banks in sales and product management.

Besides these aspects of competition and cooperation there is also a need to adapt existing business models to the changed situation due to the

demographic change in the European banking market. 50 percent of the European Banks believe action is required with regard to this issue.

In summary, it can be concluded that in the future the competition between banks in the European banking market will increase. Furthermore, the competition will be expanded across the entire value chain and involve banks and bank-related service providers. According to the survey results, the bank value chain will continue to dissolve. The depth of value creation by banks will decrease while the cooperation between banks and external service providers will increase. Nevertheless, in subsequent years the integration of the European banking markets will continue.

7.2 Assessments of Banking in 2015

Besides the development of the banking market, this survey also highlights the expected developments in banking itself by 2015. As proved by the developments in the banking market, in the future banks will also be forced to adapt their solution portfolios to the changing situation. A number of possible developments in banking are illustrated in Figure 22 and described in the subsequent sections.

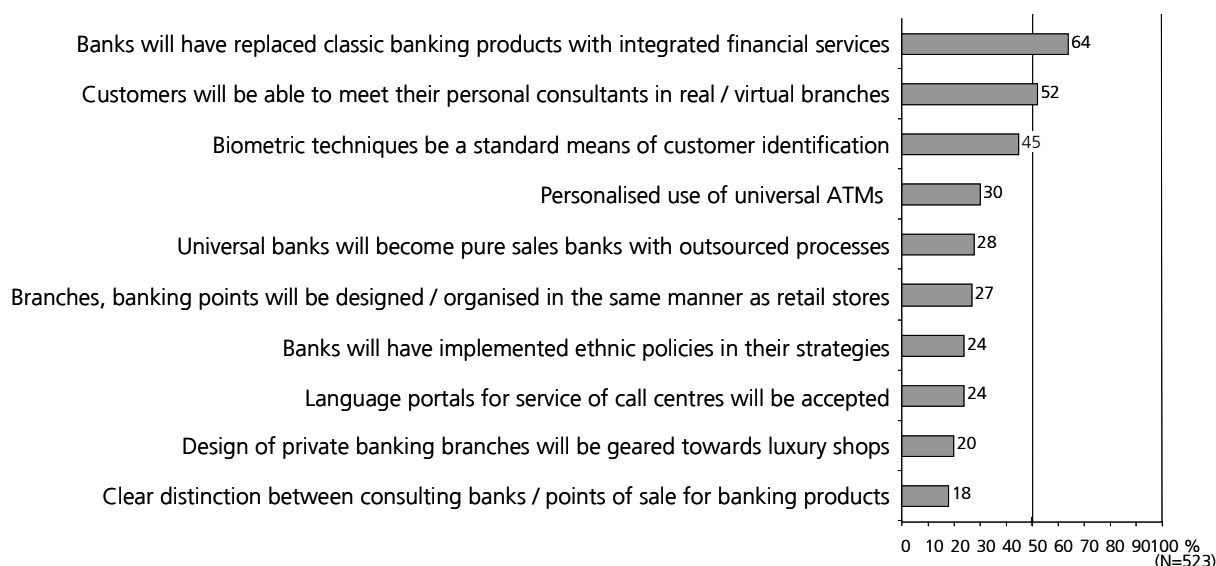


Figure 22: Assessments of banking in 2015

As highlighted in Figure 22 there are numerous trends and developments that are relevant to the future development of banking in 2015.

Integrated Services Will Replace the Competition for Standardised Products

An important aspect is a shift from product-orientated to service and customer demand-orientated banking. Approximately 64 percent of respondents expect that integrated bank services will replace classic banking products in the short term.

Fading Borders Between Real and Virtual Branches

A second important aspect is the borderless and unrestricted access to banking and advisory services. 52 percent of the participating banks consider this aspect as an important factor for future banking. This shows that the role

of emerging technologies will increase during the coming years and is underlined by the following trend.

Security and Service – Biometric Solutions

Besides unrestricted access to banking services, the authentication of persons due to biometric technologies will be an important issue for future banking. Approximately 45 percent of the respondents agreed with the idea that, in the future, banks will use biometric techniques as security standards. In addition, these services are integrated into the customer flow for customer identification and contracting, etc. In this context, a combination of different biometric methods will help to increase the level of security for authentication and transaction contracting.

Service Robots

A further technical innovation is expected in the self-service area of banks. 69 percent of the European Banks predict that by 2015, self-service terminals will have been developed into universal 'service robots' that provide cross-bank financial services. On the one hand, the service offerings of the terminals will be expanded and personalised, while on the other, mobile service robots will be able to provide all the full range of self-service options at different locations.

Conclusions on Banking in 2015

As shown in Figure 22, the developments in banking in 2015 will be strongly influenced by technological developments that will facilitate 'any-time-any-place banking' in the future. In addition to the technological developments, the service portfolio of future banks and banking business methods will change perceptibly. This applies to the layout of the branches, the business processes, the organisation and also the services offered to the customers. There is a wide variety of ways in which banks may develop in the future, but the ultimate success factor will be customers' satisfaction with banking services.

In this context the following aspect of the future-readiness of banks is an important aspect in the future development of banks.

7.3 Ready for the Future?

In the final section the bank managers were invited to state how well they feel prepared for future challenges in the banking markets (see Figure 23).

Approximately half the respondents stated that they were 'very well prepared' (32 percent) or at least 'well prepared' (24 percent) to deal with future challenges. One third of the respondents are still struggling with some deficiencies and only 12 percent believe that extensive changes will be necessary in preparation for the future.

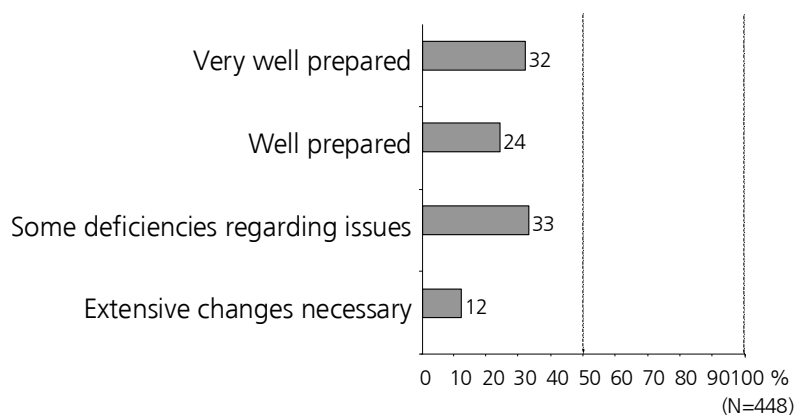


Figure 23: Are Banks Prepared for Future Challenges?

8 Conclusion

The European Trend Survey »Banks & Future« 2008 provides an overview of the ongoing challenges facing European banks and an outlook on future banking as perceived by the bank managers. Its chapters address a number of trends and actual developments in Sales Management, Bank Industrialisation and IT Management. As an overall finding of the actual European Banking Market Survey 2008, the following aspects can be summarised:

Changing Banking Markets

The establishment of an integrated European financial market is underway. Banks also expect the growth of niche players and cooperation across borders (agile and flexible) to enable them to offer value-added services to their customers.

Competition based on Service Quality and Speed

European banks are discovering that they can not distinguish themselves using traditional banking products. Besides price competition, other critical success factors such as service quality, added value and speed will gain increasing significance.

Industrialised Processes and Structures

The overall targets in the field of bank industrialisation are efficiency, effectiveness and quality of services and business processes. One important issue in the context of industrialisation is the redefinition of value chains in extended models of cooperation, as well as assessment of structural changes in banks, including the implementation of new organisational roles.

New Services within Industrialised Value Chains

Another goal of the industrialisation of banks is the creation of customer-centred services. Industrialised value chains are the enablers for an agile and flexible service composition to address changing demands in service quality and changed customer demands in new markets.

Customer Management 2.0

Banks invest in customer contact and emotional selling, without losing the benefits of bank automation and new communication technologies such as Web 2.0 and virtual sales.

Lack of Experience with Web 2.0 Solutions

The use of innovative information and communication infrastructures in customer interaction is relatively limited, but banks recognise that the use of new technologies provides new opportunities for customer interaction and customer retention. Due to the increasing maturity of Web 2.0 solutions, their adequate use can create competitive advantages for banks.

Security and Service Quality

In addition to Web 2.0 technologies, biometric solutions will be a standard feature of security concepts in the future and will be used to support

customer convenience. The combination of different biometric technologies enables the creation of highly secure solutions in different areas of the banking business.

Management Skills and Staff Development

Besides the technological developments, the human competences within banks are one of the most important factors in bank management. New bank profiles require new and different management skills. Better-informed customers ask for well-educated banking staff, while consultants demand high-quality services in all aspects of the banking business and across all interaction channels. This is a key challenge for banks all over Europe.

9 European Payments Market

9.1 Trends and challenges in the payments market

The previous chapters highlighted the general challenges that banks are dealing with in the various areas of the banking business. This special part of the survey concentrates solely on the challenges and the future of the European payments business. The current challenges and questions regarding SEPA and the challenges and questions that will arise in the near future discussed in the first part of this chapter are of particular interest.

Challenges in the payments market

The introduction of the Single Euro Payment Area in early 2008 has certainly been and still is the predominant challenge in the payments market. SEPA has raised different issues that banks need to consider. However, 69 percent of European banks believe that the most challenging of these issues – the national implementation of the Payment Services Directive – is beyond their influence and must therefore be dealt with by national governments and legislative bodies. For banks, the migration of their customers to the new SEPA instruments will be the toughest challenge in the coming years. Roughly half of the banks also feel that being able to send and receive SEPA credit transfers and direct debits, and establishing the necessary reach within Europe, will be a similarly difficult task. Interestingly, not even a third of the European banks consider SEPA Cards Framework compliance a major challenge and only 16 percent seem to be worried about how to receive SEPA credit transfers.

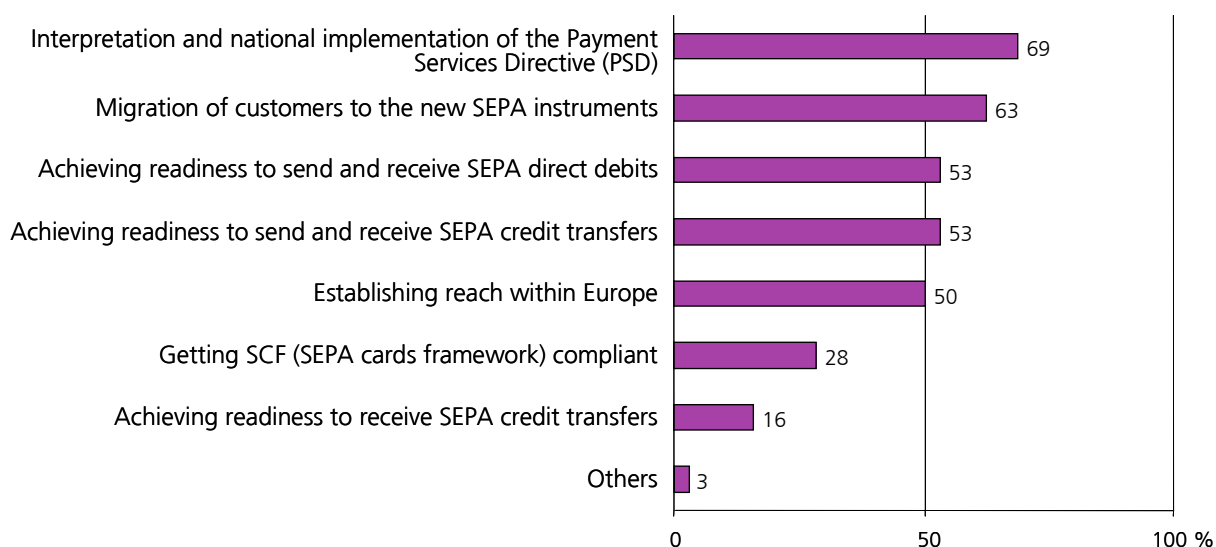


Figure 24: Main Challenges in the Payments Business in 2008

SEPA First Movers

The banks consider the migration of their customers to the new SEPA instruments the major challenge for the coming years. 84 percent of banks clearly see large corporates as first movers. This is consistent with the general market expectation and numerous statements by the EU Commission and the ECB. Despite the fact that all banks in Europe have to become SEPA

compliant and thus invest billions of euros in upgrading their infrastructures, only 59 percent of the respondents expect banks to be first movers in using SEPA instruments in their bank-to-bank payments. 28 percent of European banks believe that public authorities and administrations will be the first to use SEPA instruments. Since there is so far only a partial movement towards a migration to SEPA instruments among public authorities and administrations in Europe, the opinion of the aforementioned banks might be attributed to the persistent call by the EU Commission and the ECB for public administrations to migrate. However, despite a certain ambiguity in the market towards the SEPA migration, only 3 percent of the European banks don't expect any first movers to emerge in the coming three years.

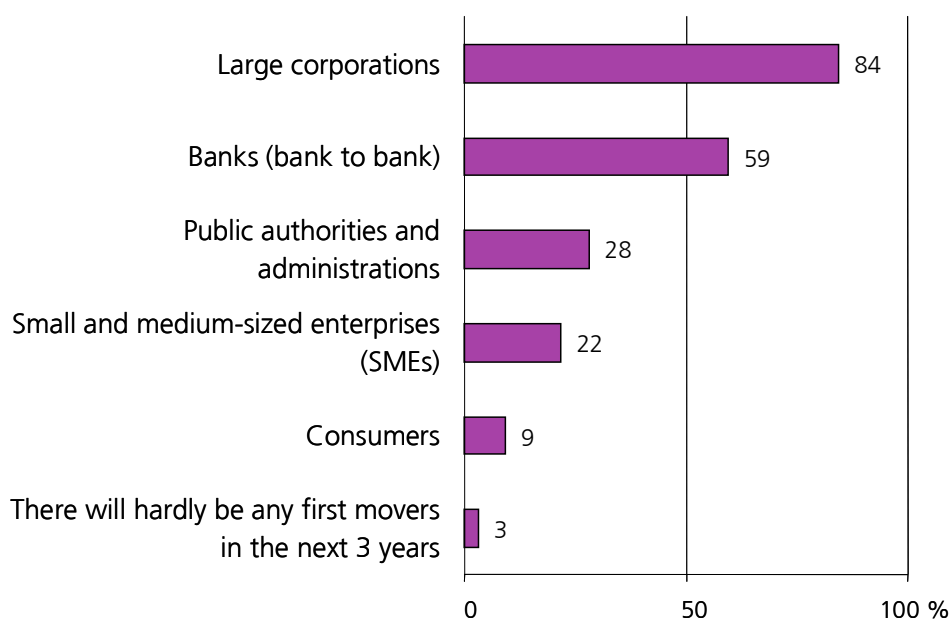


Figure 25: First Movers to use SEPA Products in the Next 3 Years

9.2 Payment Processing

Besides the necessity to achieve compliance with SEPA and the PSD and the challenge of migrating bank customers to the new European payment instruments in the coming years, the following sections highlight the different aspects in the fields of payments, cards and innovations.

Reachability

One of the major challenges expected by European banks in the coming years is the necessity to establish pan-European reach for the processing of their payments. In order to establish reach in 2008, banks seem to follow a simple formula. The current agreements, some new bilateral agreements, and the connection to the national ACH will be used for part of the SEPA volume, but complete reach within Europe will be achieved via EBA Clearing by 86 percent of European banks due to a lack of alternatives. However, as from 2009 the picture will change completely. Banks in Europe will start to set up a three-pillar reachability strategy. Bilateral agreements (58 percent), connection to one or more ACHs (58 percent) and connection to EBA Clearing (50 percent) will be the near-identical building blocks of banks' reachability strategy, which indicates that banks want to avoid dependence on one of the blocks and are looking for the most cost-efficient solutions.

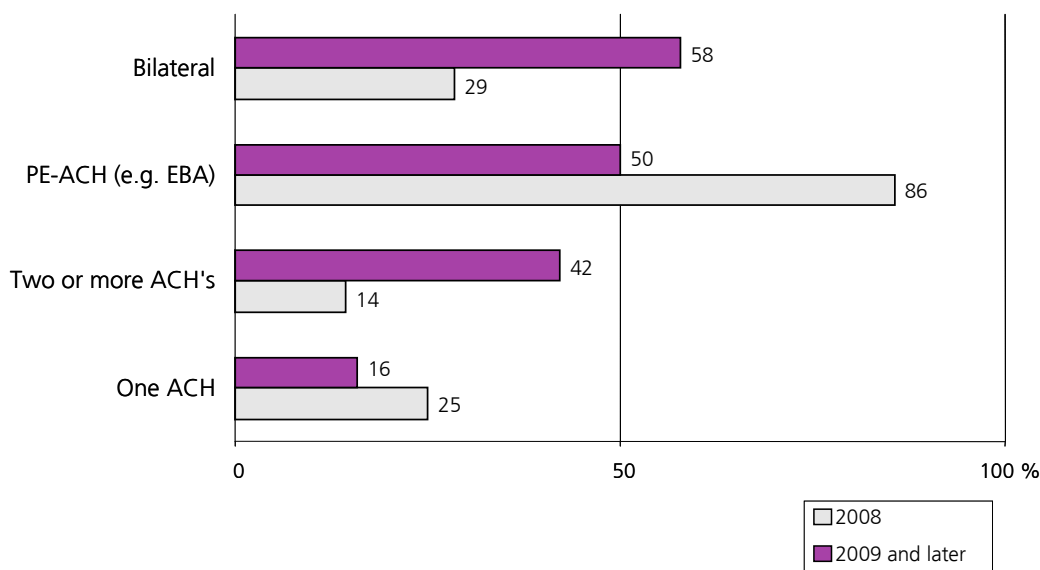


Figure 26: Establishing Reach for Payment Transactions in Europe

Selection Criteria for Payment Processors

Reachability is one issue that banks need to solve in order to ensure pan-European clearing and settlement of their payments. However, another issue that banks will investigate in the coming years is the cost-efficiency of their payment processing. Some large banks will certainly attempt to increase their payment volumes by acquiring new customers such as large corporates and other smaller banks. However, for many banks this will not be an option and 52 percent are therefore considering fully or partially outsourcing their payment processing to third-party payment processors within the next two years. It is not the price level but quality of those providers that is the most important criterion in selecting a provider. Given that none of the

participating banks are considering outsourcing their payment processing on account of the insufficient quality of their in-house processing, there is a certain fear of loss of quality by outsourcing to a third party. However, not only quality is one of the more highly rated criteria for the selection of a payment services provider. Ensuring reach as well as security and compliance are also selling propositions considered more important than pricing arguments. Many stakeholders consider additional optional services to be the distinguishing factor between banks in SEPA, while banks seem to attach somewhat limited importance to them. Only 41 percent of the European banks consider additional optional services highly important. When asked which additional optional services they considered the most important, the answers given by the banks were not surprising. The top three are IBAN and BIC conversion services (73 percent), direct debit mandate management services (63 percent) and conversion of payment formats (57 percent).

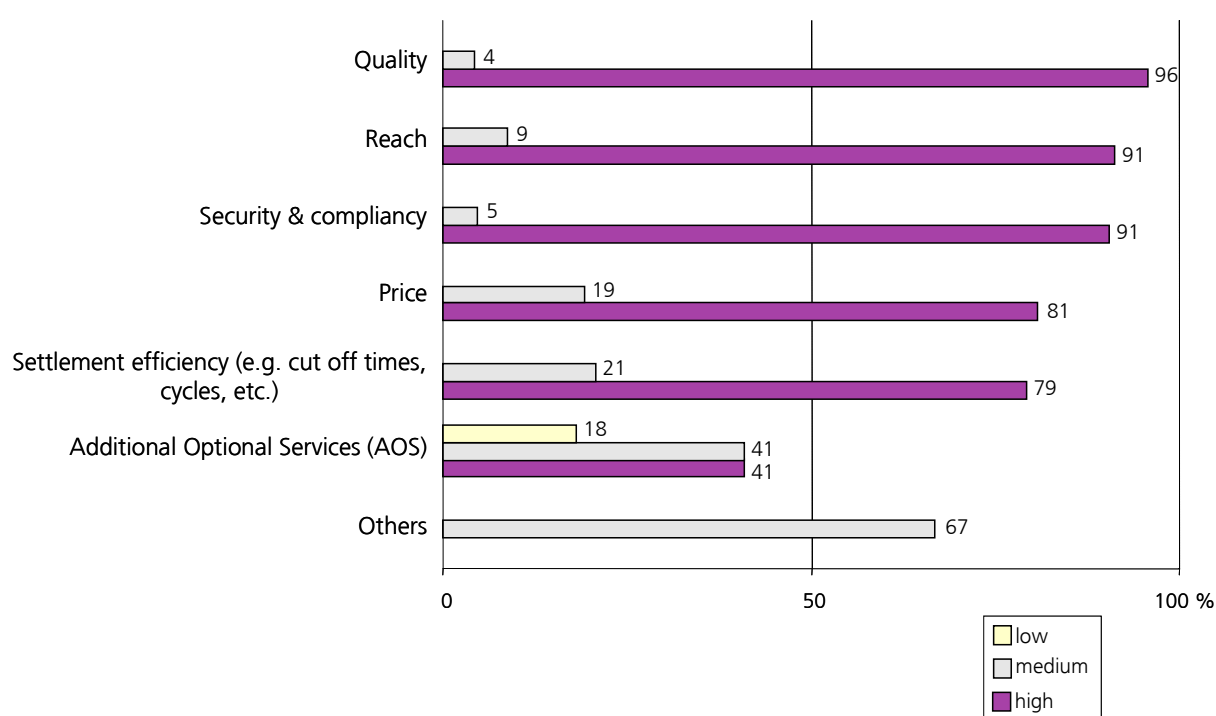


Figure 27: Top Criteria for the Selection of a Payment Services Provider in 2009 and later

9.3 Card Processing

Many banks seem to see rewarding possibilities for entering the cards market. Almost one third of the participating European banks are investigating the possibilities of becoming an acquirer for international card brands such as Visa and MasterCard. Furthermore, almost a third of the banks are interested in become an acquirer for domestic brands. 28 percent are either not sufficiently interested in the acquiring business, or are already acquirers. The discussion regarding interchange seems to have a fairly limited impact on banks' decisions to become an acquirer. The possibility to outsource part or all of the acquiring processing is even less important to banks when making this decision. This may be an indication that banks either want to continue performing these aspects of their processing activities in house, or that they believe there is already a sufficient number of card processors in the market.

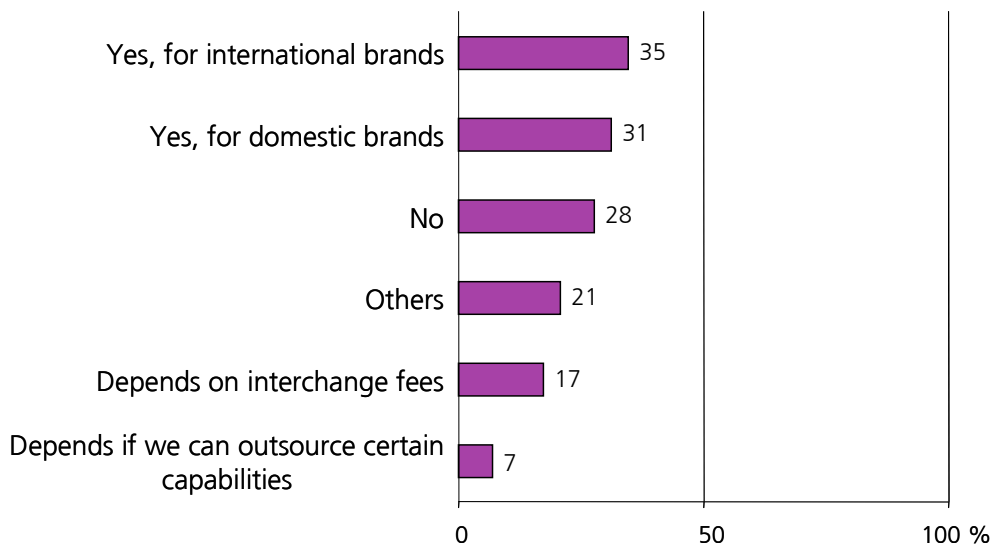


Figure 28: Banks Considering Becoming an Acquirer

9.4 Payment Innovations

Future growth and sustained profitability in the payments business of European banks will certainly demand innovative new services and products. European banks seem to have an extremely clear picture of the innovations this will involve, and which they want to deliver with a high priority. With potential savings for the European economy of up to 200 billion euros per year as stated by the EU Commission, 75 percent of the banks currently consider e-Invoicing the top innovation in the payments business. This is closely followed by e-Payments, which 72 percent of the participating banks believe has huge future potential. E-billing seems to be particularly interesting to banks with a large customer base in the consumer market. Interestingly, the innovations receiving the broadest media attention, namely contactless cards and mobile payments, are only considered potentially rewarding innovations by roughly half of the banks that participated in the survey. Even more surprising is the view of those banks on prepaid cards. Only 34 percent of the banks see future innovation potential in that sphere. However, this may also be due to the fact that the prepaid cards market is already highly mature and may no longer be regarded as a field of innovation. The importance of risk management services for card and payment transactions (e.g. online banking) may change in the future due to the shift in legal environments in many countries towards a more pro-customer attitude and the implementation of the Payment Services Directive, which limits the customers' liability to €150. However, only 41 percent of the banks currently see innovation potential in this area.

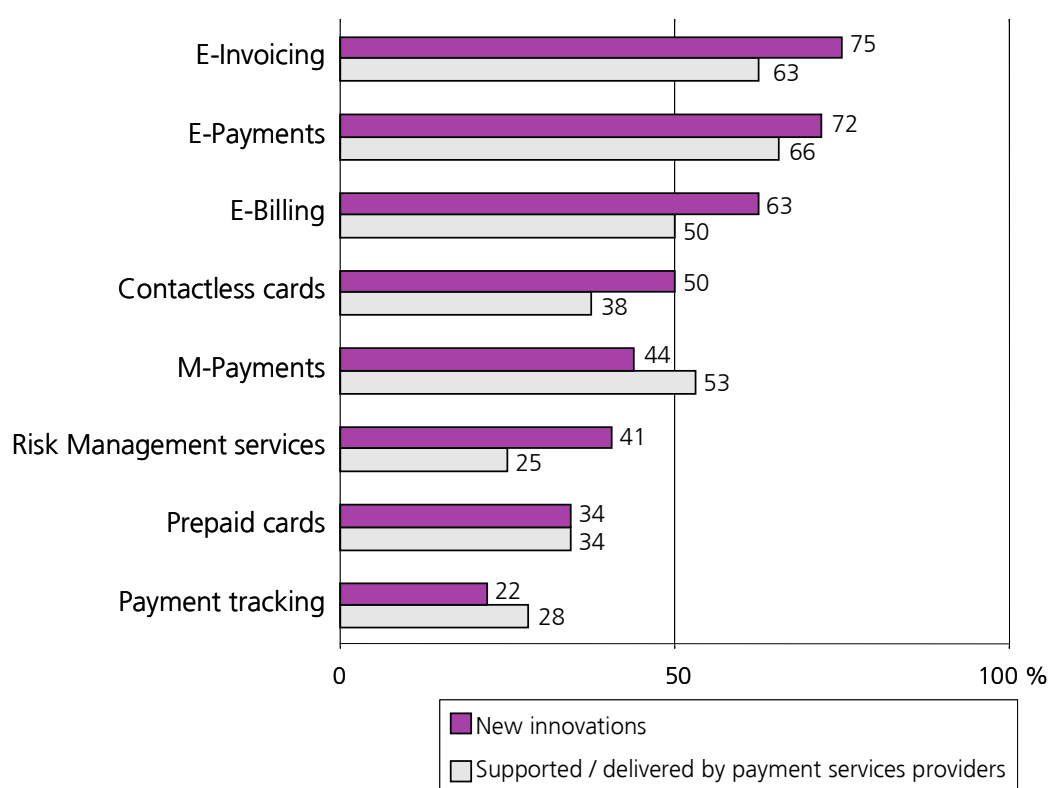


Figure 29: Payment Innovations

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Innovation forum »Banks & Future« - a conjoint research initiative

Within the innovation forum »Banks & Future« numerous banks and IT service companies have pooled their competences with regard to future trends in the banking sector under the academic direction of Fraunhofer Institute for Industrial Engineering IAO (Germany).

Their objectives are to conjointly identify market potentials and structural and technical optimisation potentials, as well as bring together users and producers of technologies in the banking sector and initiate the necessary innovation processes.

Since this research initiative was started in July 2004, the research activities have included an annual trend survey in the German banking market. Since 2007 the study has been expanded to a European Survey.

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