

**INTEGRATION AND POTENTIAL TO LEVERAGE
ELECTRONIC BANKING IN CANADA**

by

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ABSTRACT

The Canadian financial services industry has undergone rapid change in the past decade. The change is driven by the advent of considerable enhancements in technology, which has empowered the consumer to make more informed choices. This empowerment has ramifications for the industry.

This paper addresses the changes in the retail distribution networks of the banks. The banks now operate in a multi channel environment, and must adapt to integrating these channels in order to remain efficient and provide a seamless customer experience.

The paper analyzes the driving forces for the industry, and the shift towards commoditization. The value chain is described, along with identification of core competencies and sources of potential sustainable competitive advantages.

The banks compete on a cost based strategy, but in a very competitive landscape must also provide high quality service. The strategy is therefore not straightforward, and is subject to threats from competitors that are purely cost based as well as those that pursue a high quality, differentiation based strategy.

Finally, solutions are provided to address issues of leveraging the online channel and integrating multiple channels to optimize benefits to both the consumer and the bank.

DEDICATION

This project is dedicated firstly to my wife, Yasmin, who I am truly blessed to be married to, and whom I hold in the highest esteem. Thank you for keeping me grounded and for your support in all my undertakings. I am sure there is no one else who gives more of herself than you do.

To my children, Aliyah and Nabil, you were the inspiration that helped me undertake this program. I am very proud of all your achievements, your generous nature, and your integrity. You will no doubt succeed in all that you set out to do.

And to my parents, Badru and Nuru, you made a large sacrifice in uprooting your lives and moving to this country for the opportunity to give your progeny a better lifestyle. It was a dear price, and I will be forever grateful to you both. I am sure we will bear the fruits of your vision for many more generations in our family.

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1 DESCRIPTION OF ORGANIZATION

The Toronto Dominion Bank is a Schedule 1 chartered bank subject to the provisions of the Bank Act of Canada. It was formed on February 1, 1955, through the amalgamation of the Bank of Toronto, chartered in 1855, and The Dominion Bank, chartered in 1869. The bank is synonymously known as TD Bank or simply "TD".

The TD Bank and its subsidiaries are collectively known as TD Bank Financial Group. The Bank is involved in three key businesses: Personal and Commercial Banking including TD Canada Trust; Wealth Management including the global operations of TD Waterhouse; and Wholesale Banking including TD Securities.

TD Bank Financial Group serves more than 13 million customers, and was the third largest bank in Canada in terms of market capitalization as at its most recent fiscal year ended October 31, 2003.¹

1.1 Personal and Commercial Banking

This business serves approximately 10 million personal, small business, insurance, and commercial customers, under the TD Canada Trust brand. Management's goal is to derive 80% of earnings from its retail businesses – personal and commercial banking, and wealth management. As at fiscal year ended October 31, 2003, these businesses delivered 76.7% of total earnings.

Personal deposits consist of a full range of chequing and savings accounts, term investments, and retirement investments to promote primary banking relationships. Consumer lending suite of products includes lines of credit, mortgages, and Visa charge cards. Insurance products are marketed through TD Life Group providing life and health protection, and TD Meloche Monnex, which is the largest insurer for home and auto insurance in Canada.

¹ TD Bank Financial Group 148th Annual Report 2003.

Small business banking covers the delivery of deposit, lending and cash management services across the branch network and via Internet banking to nearly 650,000 customers². Merchant Services provides debit and credit card payment solutions with point of sale technology to over 85,000 merchant locations in the country.

Commercial banking offers lending, deposit, cash management, trade and treasury services to 57,000 medium sized businesses via Commercial Banking centres in major urban locations across the country.

1.1.1 Wholesale Banking

This business services Corporate, Government, and Institutional clients. Revenues are derived primarily from corporate banking, investment banking, capital markets and investing activities under the TD Securities umbrella.

Due to the strained operating environment resulting from heightened concerns over recent corporate governance issues, the bank has retrenched its activities considerably during the past two years. It has repositioned by providing corporate banking to only those core clients that are well established with the bank.

1.1.2 Wealth Management

Delivery channels are comprised of TD Waterhouse Discount Brokerage, Financial Planning, and Investment Advice. Other businesses within this segment are TD Mutual Funds, Private Client Group, and Asset Management.

TD Bank pioneered self-directed investing when it launched Green Line Investor Services discount brokerage in 1984. Through acquisition, it has evolved into TD Waterhouse, which is now one of the largest self-serve brokerage firms in the world. It represents 67% of the total revenues of the bank's wealth management group, and serves customers in Canada, United States, and United Kingdom. Discount Brokerage has nearly 1.1 million retail accounts, with \$55 billion in assets under administration³

² Andrea Rosen, President, TD Canada Trust, *New Director Orientation*, January 23, 2004, Toronto, Ontario.

³ John See, President, TD Waterhouse, *Senior Management Meeting*, Vancouver, December 16, 2003.

To capitalize upon the well-recognized Waterhouse brand, the bank integrated its full service broker, formerly Evergreen Investment Services, and its Financial Planning arm up into TD Waterhouse. TD Waterhouse Investment Advice provides full-service brokerage to retail customers. TD Financial Planning provides a full range of proprietary and non-proprietary mutual fund and non-brokerage sales and advice to customers primarily referred through existing bank channels. Financial Planning was established in the late 1990s, and is now witnessing rapid growth as more Planners are deployed. Approximately 20,000 households were serviced as at December 2003, with \$3.5 billion in assets administered, the latter representing a growth of 84% over 2002.

TD Mutual Funds is the seventh largest mutual fund family in the country with \$31 billion in assets under management as at October 31, 2003. These funds are sold through TD's various delivery channels in the majority, but are also sold as third party funds by other financial services firms.

TD Private Client Group includes trust services, private banking and Private Investment Counsel. This group caters to high net worth clients who require sophisticated investment vehicles, and estate planning.

TD Asset management is one of the largest quantitative managers in the country, providing investment management to pension funds, corporations, institutions, endowments, and foundations.

1.2 Products and Services

A myriad of products and services are provided by the TD Bank. The focus here will be on those provided through its retail distribution arm, TD Canada Trust. These products and services are homogenous, as all major competitor firms have the ability to provide the same.

1.2.1 Core Banking

The core banking proposition for Personal and Business Banking customers provides:

- a) The ability to transact...obtain cash, issue cheques, access to electronic settlement, pay utility bills, and other transactions necessary to conduct normal daily banking;
- b) A deposit account...to draw from to fund transactions; a day to day operating account;
- c) A 'transactional' loan account...overdraft protection on an account or a Visa charge card;
- d) Record keeping...a record of the customer's day-to-day banking for verification and future reference, for example passbooks, monthly statements, online web based records that can be downloaded to record keeping software.

The above represent chequing and savings accounts, Debit/Access cards for electronic settlements at merchant points of sale, and Visa cards to make purchases on credit. These may be bundled into one or more services to facilitate convenience and pricing. For example an Emerald Service plan bundles a Chequing account with unlimited transactions at no additional cost, an Emerald preferred rate Visa card, a safety deposit box at not extra cost, and Web banking, for a flat fee of \$25 per month. Another bundle called the Value package includes a chequing account that allows 2 in-branch transactions with teller service, 10 transactions at ATM's, and access to Web banking, for a fee of \$3.95 per month. Similar bundles are offered for Business Banking accounts.

1.2.2 Extended Product Offerings

Once consumers establish their core banking, the bank then earns the opportunity to deepen and extend the relationship with the customer, into longer-term products:

- a) Savings and Basic Investing...term deposits, guaranteed investment certificates, retirement savings plans, and mutual funds. All these vehicles have a variety of offerings within each category, to suit a broad array of consumers. The bank has a family of 64 mutual funds for example, to provide a selection to meet individual investors risk tolerance, investment time frame, purpose of the investment, stage of life that the investor is at, and where a particular investment fits within the overall financial plan of the customer.
- b) Borrowing...mortgages, lines of credit, and loans. Real estate secured loans and mortgages could be to assist with the purchase of a residence, an investment property, or to invest in a business venture. Loans are generally

provided for specific purchases, whereas lines of credit are intended for convenient access to credit when required.

1.2.3 Complex or Specialized Customer Needs

This is where products are customized to individual needs. While all competitor financial institutions offer these services, the services are differentiated by the fact that the needs are unique to each customer.

- a) Commercial banking...cash management services such as collection of receivables, distribution of funds to suppliers, automated payroll system, and credit facilities such as operating lines of credit for financing of receivables and inventory, leasing facilities, and term loans for capital purchases. In a commercial banking relationship the customer looks to the bank for advice on matters beyond banking, and the bank account manager becomes integral to the company's operations and is often called upon when a company is contemplating major transactions.
- b) Financial Planning and Investment Advice...for those customers who have upwards of \$100,000 in invest-able liquid assets, customized planning services are provided to manage their investments. For those who require full brokerage services, these are provided by Investment Advisors who are able to transact in stocks as well as other sophisticated investments.

1.2.4 Other Products

- a) Life and Health insurance...sold as credit protection to borrowers. Should a borrower die or become disabled, the debt would be paid out under the insurance coverage. Life insurance, primarily term insurance, is also sold.
- b) Auto and Home Insurance...property and casualty insurance sold to individuals. Also packaged as Group Insurance for companies.

Recognizing that the majority of the bank's products and services are homogenous, it is necessary to have an efficient cost structure. In an effort to improve efficiencies and have a focused strategy, the bank recently integrated the businesses that deliver the above services under the TD Canada Trust umbrella. These are now managed by one business head with overarching responsibility for retail distribution, which will enable leveraging each business to the benefit of other businesses within retail distribution.

1.3 Delivery Channels

Various channels are used to reach and optimally serve customers:

1.3.1 Bricks and Mortar

This is the conventional channel most familiar to consumers. It has high visibility and its presence gives the banks a competitive advantage over new entrants and non-national financial institutions. TD Canada Trust has a network of 1,010 branches⁴ across the country, with FTE of 17,299, and \$275 billion book of business. The average branch size is 4400 square feet. In 2003, the branch network processed 276 million transactions.

1.3.2 Telephone Banking

This channel is branded Easy Line. It offers Interactive Voice Response (IVR) technology, and is available 24/7. Basic banking services are available. During 2003, this channel carried out 126 million transactions, which was down 7% over the prior year.

1.3.3 Automated Banking Machines (ABM)

All banks have an extensive network of ABM's. In addition, non-branded 'white label' ABM's have become very popular in recent years. TD's ABM's provide an increasing array of services, although the most common uses are fund deposit and withdrawal, bill payments, and account enquiry. In 2003, 263 million transactions were performed, down 2% over 2002.

1.3.4 Accesscard

These are debit cards used at merchant points of sale to pay for purchases. They have gained wide acceptance and have reduced usage of charge cards in many instances, primarily for small ticket purchases. During 2003, 469 million transactions were conducted, an increase of 8% over prior year.

⁴ Tim Hockey, Executive Vice President, TD Canada Trust, *New Director Orientation*, January 23, 2004.

1.3.5 Web Banking

This is branded Easy Web. It offers 24/7 online banking access. This service started out providing basic banking services, and continues to expand its offerings. We anticipate that with the evolution of technology, in the near term this channel will offer almost all of the services available through the branch network, and develop the capabilities to offer more sophisticated financial planning transaction and advice.

This is the fastest growing channel. During 2003, 450 million transactions were performed, an increase of 36% over 2002. We expect Web Banking will overtake Accesscard in number of transactions in 2004.

1.3.6 Other Channels

- ❖ Commercial Banking Centres...these are bricks and mortar centres located in major urban areas. They service mid market and junior corporate companies, and house a group of experts that specialize in more sophisticated commercial transactions.
- ❖ Financial Planning...a group of dedicated financial planners that provide services through the branch networks.
- ❖ Discount Brokerage...through TD Waterhouse, self-serve brokerage is offered at discount prices. No advice on stocks or investments is provided, but research tools are available. Service available online or through telephone.
- ❖ Investment Advisors...full service brokerage, providing advice and fulfillment of orders for stocks or other investments.
- ❖ Private Investment Counsel...discretionary wealth management for more sophisticated clients who prefer to have all their investments managed by specialists.
- ❖ Mortgage Sales Force...specializes in sourcing personal mortgage business, and placing the same in the branch network for servicing.

1.4 Conclusion

The purpose of this chapter was to provide an overview of the company, its organizational structure; products and services it offers, and the market share it holds relative to its competitors.

The industry will be analyzed in the following chapter including an assessment of the competitive risk, and the key success factors.

2 INDUSTRY ANALYSIS

Canada's five largest banks (the Big Five) are The Toronto Dominion Bank, The Royal Bank of Canada, The Canadian Imperial Bank of Commerce, The Bank of Nova Scotia, and The Bank of Montreal. These five financial institutions dominate the market in consumer banking in the country. These are the only banks that are truly national in scope, with bank branches in all provinces in the country. In addition, the National Bank of Canada has a meaningful presence in Ontario and Quebec; and HSBC Canada (which is a subsidiary of Hong Kong and Shanghai Banking Corp. headquartered in London, England) has branch operations in British Columbia and Ontario and is rapidly expanding its presence across the country with the recent acquisition of Household Finance Canada.

According to the Canadian Bankers Association⁵ in addition to the large chartered banks, the industry includes 9 smaller domestic banks, 33 foreign subsidiaries, 25 trust companies, 100 Life Insurance companies, 1700 credit unions and caisses populaires, and numerous boutique financial services providers. Most of these provide some of form consumer banking services through retail distribution networks.

The Canadian banks are smaller than their competitors around the globe. Table 1 provides some perspective of their relative size⁶.

2.1 Competitive Analysis

The overall competitiveness of retail distribution in the financial services industry is currently considered to be *High*. The largest banks have historically competed aggressively with each other for market share, but in recent years many new players have entered the industry with the evolution of financial reform in Canada. In addition, technological advancements have resulted in increased efficiencies in the delivery of

⁵ Canadian Bankers Association, *Fast Facts*, January 2003, www.cba.ca/en/viewDocument.asp?fl=6&rsl=111&rtl=&rdocid=451&rpg=1, accessed May 15, 2004.

⁶ Data from the Top 150 Banks Worldwide ranked by Asset size, *The Banker*, July 2003.

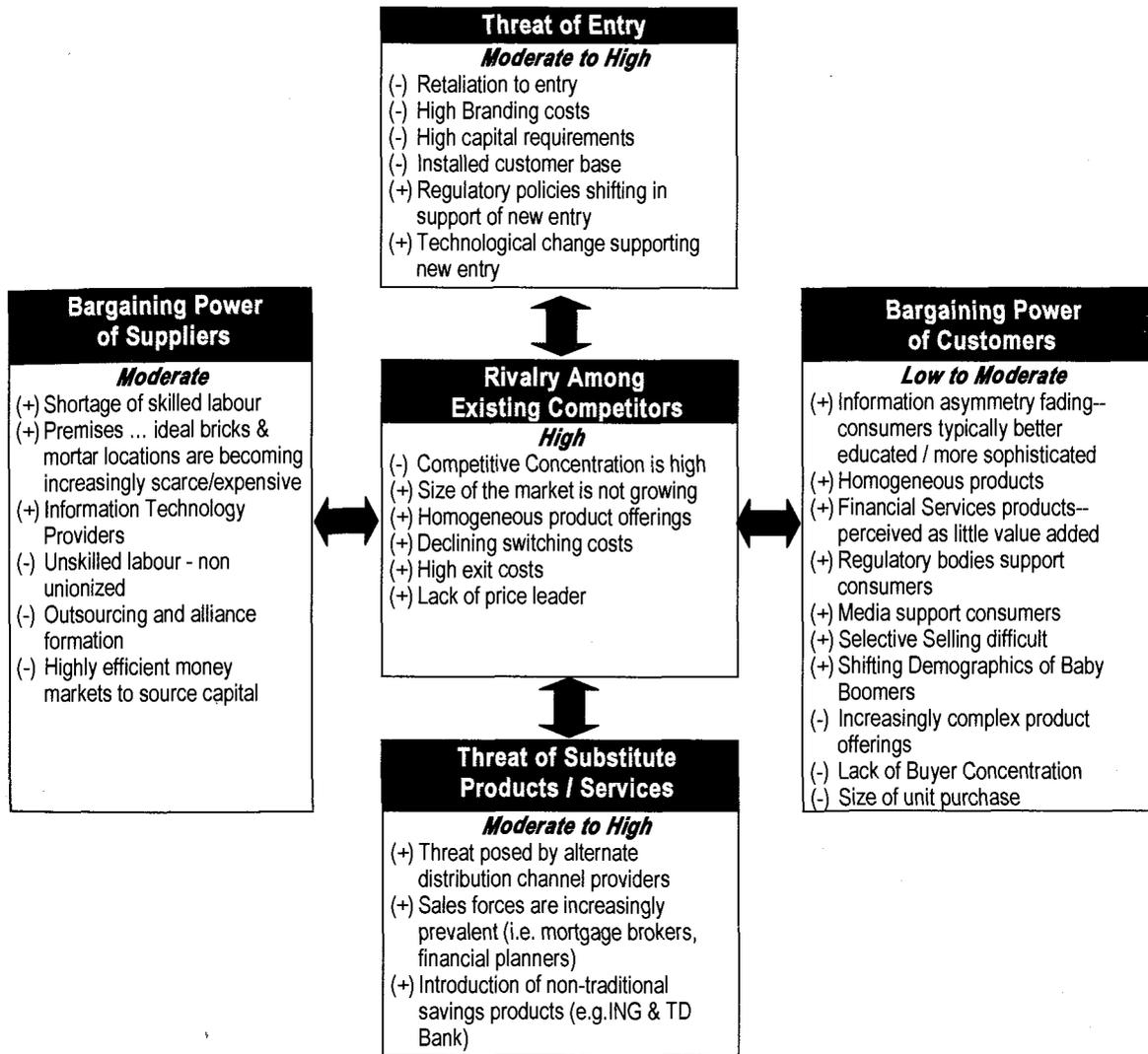
financial services. As a consequence the market has now become crowded, further intensifying competition.

Table 1: Excerpts of Bank Rankings Worldwide

Asset Rank 2002	Bank	Country (Year End)	Assets (\$millions CDN)
1	Citigroup	U.S. (12/02)	1,730,927
2	Mizuho Financial Group	Japan (03/03)	1,705,013
3	UBS	Switzerland (12/02)	1,343,620
4	Sumitomo Mitsui Financial Group	Japan (03/03)	1,332,700
5	Deutsche Bank	Germany (12/02)	1,254,594
6	Mitsubishi Tokyo Financial Group	Japan (03/03)	1,232,200
7	HSBC Holdings	U.K. (12/02)	1,197,786
8	JP Morgan Chase	U.S. (12/02)	1,197,083
9	BNP Paribas	France (12/02)	1,175,126
10	HypoVerinsbank	Germany (12/02)	1,143,424
11	Credit Suisse Group	Switzerland (12/02)	1,087,138
12	Bank of America	U.S. (12/02)	1,041,939
13	Royal Bank of Scotland	U.K. (12/02)	1,024,497
14	UFJ Holding	Japan (03/03)	1,012,067
15	Barclays Bank	U.K. (12/02)	1,006,424
51	Royal Bank of Canada	Canada (10/02)	377,721
60	Scotiabank	Canada (10/02)	296,380
64	Toronto Dominion Bank	Canada (10/02)	278,040
65	Canadian Imperial Bank of Commerce	Canada (10/02)	273,293
66	Bank of Montreal	Canada (10/02)	252,864

Please refer to the analytical framework as presented in Figure 1⁷. The five forces identified by Porter⁸ are used to analyze the competition in this industry: rivalry among existing competitors; threat of entry; threat of substitutes; bargaining power of customers; and bargaining power of suppliers.

Figure 1: Canadian Retail Banking Industry



⁷ Adapted from template by Dr. Ed Bukszar, Simon Fraser University, supplied to EMBA class January 2004.

⁸ Adapted from Michael E. Porter, Industry Structure and Competitive Strategy: Keys to Profitability, *Financial Analysis Journal*, 1980.

2.2 Rivalry among Existing Competitors

Rivalry is intense, and is considered a High competitive risk.

(+) The size of the market is not growing, while the number of financial institutions is increasing, essentially carving up the pie into smaller shares.

(-) High competitive concentration: while the number of competitors is increasing, the Big Five banks hold the dominant share. Therefore, competition is concentrated amongst a few players for now. Considering the sizable market in Canada however, the five are not as competitive as it would appear on the surface. In the consumer banking business, a sufficient market exists for each to carve out a meaningful share. Each of the Big Five has found some niche markets that the others don't compete in, making it more challenging for smaller competitors to take away share. Entry is occurring however, thus the concentration ratio is becoming lower. This is likely to continue over the next 5 to 10 years. Three life insurance companies offer a full range of banking services, and are comparable in size to the major banks in terms of market capitalization. Two primary reasons for increasing competition are: a) enhancements to technology, which enable delivery of services more efficiently using electronic means. The large financial institutions have bank branches across the country, giving them an advantage with their physical presence. This advantage will be increasingly less valued as alternate channels become more efficient and are accepted by consumers; and b) the continued loosening of policies restricting foreign banks to establish themselves in Canada.

(+) Homogenous products and services: Canadian banks are nimble and can quickly duplicate products introduced by rival banks. Products and services have become homogenous, and there is little differentiation particularly amongst the large banks. Any advantages due to product innovation are very short term, especially if the product is successful. The large banks monitor each other closely. There is large concentration of banks in Ontario and Quebec, which makes it that much easier to monitor.

(+) Low switching costs: it is very easy for customers to switch banks. Products and services are similar. The banks attempt to lock in customers by bundling services and with relationship based selling, but effectively if a customer wishes to switch, a

competitor bank will make it very convenient to switch. If there are costs involved, quite often the receiving bank will cover a portion of these.

(+) The costs to exit the industry are very high. The banks spend considerable sums on building brand identity in order to create a degree of differentiation. Large infrastructure costs are necessary to set up bricks and mortar channels, clearing systems, networks of automated teller machines (ATM's), clearing systems, Visa and Debit Card facilities, compliance processes to satisfy regulatory requirements such as those of the Investment Dealers Association, Office of the Superintendent of Financial Institutions (OSFI), Securities Commissions, and so on. Many of these costs are sunk therefore; to exit would mean suffering losses on these capital investments. Also, it is very challenging for banks in Canada to merge or acquire in the present environment so exit through acquisition is blocked.

(-) There are no price leaders as the Big Five are relatively equal in size. These firms have the capabilities to match prices and withstand a drop in margins or even short-term losses on certain products as they are all financially sound. For example, in the past six months, the Royal Bank decided to increase its share of the residential mortgage business and introduced competitive interest rates bundled with a no-fee package (property appraisal expense and legal costs to complete the transaction were covered by the bank). The Big Five countered with similar packages, with the result that any gain in market share for the Royal Bank would come at the expense of other competitors who may not be in a position to withstand such prices for a sustained period.

2.2.1 Threat of Entry

The threat of entry is increasing and is considered Moderate to High.

(+) Regulatory policies: Historically the regulatory environment has favoured restrictive entry into the industry. Since the 1990s the Canadian Banks, particularly the Big Five have been lobbying for reform. The industry is witnessing a consolidation in other parts of the world, with the result that the Canadian banks are losing their competitive muscle due to scale effects globally. The Canadian Banks are therefore pressing for lifting the stifling restrictions to allow mergers and acquisitions within the industry. The regulatory environment is gradually changing, allowing entry to foreign

competition, reducing the requirement for capital reserves, allowing Insurance companies to sell banking services, and so on. As a result of the friendlier regulatory policies, it is conceivable that a large, well-established foreign bank will enter in the medium term, possibly acquiring one of the smaller Canadian banks.

(+) Technological changes: with the advent of substantial advancements in technology, it is now more efficient to deliver financial products and services through alternate channels, i.e. other than bricks and mortar branch locations. Banks now provide choices to consumers to conduct their banking online, through the telephones, via ABM's, or traditional bank branches. We are witnessing entrants such as ING and Citizens Bank establish virtual banks, with only one or two representative offices in the country. They offer a network of telephone and online banking, and form alliances with other financial institutions to provide charge cards, mutual funds, ABM's, and other services.

(-) Retaliation to entry: as we discussed above in the example of the Royal Bank intending to increase market share in mortgages, the Big Five employ the same retaliatory strategy to others attempting to wrestle away market share in traditional banking activities. New entrants typically find niche markets, for example MBNA Bank aggressively seeking charge card business, ING establishing a virtual bank, and President's Choice pursuing the lower end, transactional side of the business. These entrants have made inroads but not without retaliation, particularly ING which faces tough competition for residential mortgage business.

(-) High branding costs: the well-established banks have the benefit of long histories on their side. Consumers are familiar with the names of these banks, as well as their colours (Royal blue, TD green, and so on). Over the years the banks have developed core competencies in building their brands. They are household names across the country given their national bricks and mortar presence for so many decades. They also advertise extensively, and contribute significantly to national and local charities. All this provides them with brand awareness that would take a new competitor considerable time and expense to build.

(-) High capital requirements: in order to make a significant impact on the industry, an entrant would have to invest in building a national presence. Canada is a

vast country with a low population base. It is therefore expensive to establish a coast-to-coast network of branches and ATM's. Returns on investment may not be at acceptable levels for an entrant until a critical mass is developed.

In addition, banking by its very nature is a capital-intensive business. Not all funds received on deposit from customers can be lent out. Prudent levels of reserves need to be maintained.

Regional entry is possible. The credit unions have been successful in establishing themselves as community banks; HSBC first entered by acquiring the assets of Bank of B.C., and gradually expanded across the country through acquisition and organic growth.

(-) Installed customer base: existing banks have a large base of customers. While customers may switch banks with relative ease, generally there has to be a sufficient cause to do so. Typically customers switch due to poor service levels, although some are enticed by lower pricing. The latter is not a sustainable advantage as prices are generally low for most services and are not a differentiator. It is therefore more challenging for an entrant to make quick inroads into the market.

(+) Low switching costs: as we discussed above under Rivalry Amongst Existing Competitors, customers can switch banks with relative ease and at minimal cost.

2.2.2 Threat of Substitute Products and Services

With the recent proliferation of alternate channels and advancement in technological capabilities, this factor is considered to be of increasing risk to competition. It is therefore rated as Moderate to High.

(+) Alternate distribution channels: these include non-traditional 'in-store' bank branches conveniently located inside grocery superstores such as Loblaws, Safeway, and Real Canadian Superstore. Existing banks are forming alliances with these stores to distribute their products, providing location convenience, as consumers typically visit to make their grocery purchases. The Internet has enabled web based banking, with almost all domestic banks providing electronic banking facilities. According to the

Canadian Bankers Association⁹ year over year growth (2002 over 2001) of Internet banking was 45.6%. This compares to 10% for Debit Cards, -2.7% for Telephone Banking, and -0.2% for ABM's. While the number of transactions carried out on the Internet is much smaller than Debit Cards or ABM's, it is growing rapidly. As banks participate in these substitutes, they are rendered less significant threats.

(+) Sales forces: Specialized sales forces are becoming prevalent now. Sellers of financial products that specialize in certain products are gaining wide spread acceptance. Mortgage specialists now consist of brokers who are either employed by banks or work externally in their own companies or broker companies. They are intermediaries between consumers that require financing, and financial institutions that underwrite and fund the mortgages. Similarly, financial planners work for franchise operations such as J.D. Edwards, and sell third party funds. Banks are also able to sell third party, non-proprietary funds via their in house financial planners, subject to certain regulatory compliance requirements.

(+) Non-traditional deposit and lending products: Financial institutions are becoming more aggressive in introducing innovative products in their drive to provide increased convenience to consumers. ING for example, introduced a single bank account that permits cheque-writing privileges as well as earn a high rate of interest. The TD Bank introduced a credit facility that combines fixed rate and floating rate options within the same product. This facility affords flexibility and convenience as it can be utilized for mortgage financing to purchase a home, or any other credit need that the customer may have.

2.2.3 Bargaining Power of Customers

With the transparency of information that is now prevalent, and the increase in competition amongst financial institutions, customers have increasing bargaining power, although this factor is still rated Low to Moderate.

(+) Information asymmetry: information is widely available. Consumers are better educated, and the Internet enables improved dissemination of information. Competition

⁹ Selected Delivery Channel Statistics, 2002, Six Banks- Big Five + National Bank of Canada www.cba.ca/en/content/stats/040622-delivery%20channels%202003-leaj.pdf, accessed May 29, 2004.

has increased with a rise in the number of specialists in various fields within the financial services industry, resulting in increased education for consumers.

(+) Product homogeneity: offerings by the various financial institutions have little differentiation. If new products are introduced by a competitor and are viewed as potentially successful, they are quickly duplicated. Customers are therefore able to choose amongst financial institutions and have access to their preferred product.

(+) Commodities with little value added: financial services products are perceived to provide nominal added value. Most products have characteristics of commodities that are available at several competing institutions.

(+) Regulatory policies: Consumer protection measures include increased disclosure requirements on the part of the seller. Banks must therefore make their transactions transparent, with full disclosure of all borrowing costs, interest rates on deposit instruments, bank account fees, and such.

As well, increased consumer privacy standards place more power in the hands of the customer. For example, banks must obtain consent to disclose any information to third parties, and give the customer the option of whether the bank may use their personal information in its own marketing and solicitation efforts.

Tied selling is also not permitted, i.e. the bank cannot make it a condition that the customer must purchase certain products.

(+) Media: banks are popular targets for "media bashing" given their size and influence in the country. The pop culture in Canada is to look unkindly upon anything that is successful and capitalistic in nature. This plays into the lobbying efforts by those who are anti big business.

(+) Selective selling: it is difficult for banks to target selectively, although this is being done increasingly. Banks must make products available to all of their customers without undue preference. Recently though, technology has enabled portfolio segmentation which assists in identifying and target marketing to appropriate segments.

(+) Demographics: the baby boomers in Canada are shifting to the life stage where they are accumulating wealth. This gives them increased bargaining power, as

wealth management is a profitable business for the banks and they compete aggressively for it.

(-) Complex products: As consumers become more sophisticated, and technology enables product innovation, banks offer more than just vanilla products. Customers with high net worth and complex financial arrangements in their businesses are typically offered more complex products and services through Private banking and wealth management units.

(-) Buyer concentration: there are a large number of buyers in relation to the number of suppliers of financial services. It is difficult for individual consumers or businesses to have a significant influence on banks and their policies. If they are unhappy their only meaningful option is to switch in order to penalize the bank.

(-) Size of unit purchase: Each customer's purchase is relatively small in relation to the number of transactions carried out by the banks; therefore they do not carry much bargaining power. The largest corporate customers may carry some influence, but even these are often syndicated so that banks are not exposed unduly to a single entity. Most large corporations have multiple banking arrangements – this works to the benefit of both the customer and the bank as neither party wishes to be beholden to the other.

2.2.4 Bargaining Power of Suppliers

This factor is considered a Moderate risk. Labour is specialized in certain parts of the industry, and prime physical locations are expensive and increasingly scarce. Alternatives can be found to meet some of these challenges.

(+) Shortage of skilled labour: in specialized areas such as financial planning, full service stock brokerage, and life insurance sales, employees with specific skills and academic qualifications are required.

(+) Bricks and mortar locations: these are increasingly expensive to acquire and operate in urban centres. The large banks have traditionally secured prime corner sites, in close proximity to customers. Mitigating this risk somewhat are the alternate channels discussed earlier, which are gaining in popularity.

(+) Information technology providers: technology requirements of the financial institutions are complex and there are only a few companies that can meet them. These companies, such as IBM, therefore can have considerable power, particularly after a bank has become entrenched (lock-in) with the supplier, as switching costs could be formidable both in terms of invested capital and time.

(-) Unskilled labour: a majority of the employees are trained on the job, and can be hired with relative ease. The jobs are sufficiently attractive with good working conditions and benefits. Such positions are in demand, and supply is ample. Most of the banks are not unionized, so employees have low bargaining power.

(-) Outsourcing: the banks increasingly outsource many of their routine operations. Back room work like filing is outsourced to companies such as Iron Mountain, who provide secure and confidential filing and retention services. Alliances amongst some of the banks led to the formation of Symcor, a company that is contracted to run cheque clearing and data centre operations. Other examples include Securicor, which provides courier services for the banks' internal documents that are processed daily overnight, and Brinks that looks after currency pick up and delivery. Such alliances amongst the competitor banks and outsourcing reduce bargaining power of suppliers.

(-) Improved efficiency in financial markets: historically the banks used to source their funding for making loans largely from customers that entrusted them with their deposits. In the modern era capital markets have become very efficient. Financial institutions can arrange funds from a variety of sources, such as bond and equity markets, and issue sophisticated financial debt instruments to raise capital. There are many players in the markets and are spread out across the world. This therefore reduces the bargaining power of suppliers of capital.

2.3 Overall Assessment of Competitive Risk

Overall, the international banking industry has experienced a massive shift in competition in the past decade. There are various reasons for this.

The industry was subject to a variety of restrictive regulations in different countries, which regulations were necessary and appropriate for the prevailing times. Regulations are now becoming less restrictive. To use the United States as an example, banks there were licensed to operate only in one state for a long period. After those restrictions were lifted, many mergers resulted as the banks started to find they needed scale to survive and to defend against being acquired by stronger competitors. This consolidation led to the creation of some very powerful banks, and we have now seen the emergence of institutions such as Citibank and J P Morgan Chase. The consolidation there is continuing.

Similarly, banks in Europe and Asia are undergoing consolidation, for reasons that are specific to their own changing environments. As a consequence, these banks have the size and financial clout to enter into other countries. The Banks in Canada are restricted by regulators from merging, but are under considerable pressure to grow in order to not only defend their businesses in their own territories but also to expand into other parts of the world, to diversify operations and potentially improve their profitability.

Another significant change evolved in Canada with the fall of the traditional four pillars: insurance, banking, brokerage, and trust. These businesses have now evolved into essentially two large groups – Insurance and Banks. Each can provide all of the services that were formerly separated as four pillars of the financial industry. We have witnessed banks and insurance companies merge with and acquire trust companies and stock brokerage houses. As well, those banks and insurance companies that were smaller and not as financially sound have been acquired. We have also witnessed credit unions, which are much smaller in size and financial strength; begin to merge. They need to keep up with expensive technology advancements, and be able to afford the costs that are necessary to set up alternate channel infrastructure.

Many of these changes are driven by technological enhancements. These have meant that financial services can be delivered much more efficiently, and without the need for expensive physical branch banks. ABM's for example, are ubiquitous. According to the Government of Canada's Department of Finance¹⁰, the six largest

¹⁰ Canadian Financial Services Sector, *Canada's Banks Publication*, Statistics, August 2002 www.fin.gc.ca/toce/2002/banke.html accessed June 7, 2004.

banks have 14,000 ABM's across the country. In addition there are numerous 'white label' (non-proprietary) ABM's located inside hotels and in other high consumer traffic areas. The evolution of electronic banking, telephone banking, and debit cards has resulted in consumers not having to visit a bank branch for most of their routine banking transactions. And increasingly, non-routine transactions such as applying for mortgages or purchasing mutual funds can be accommodated through call centres or the Internet via personal computers.

All of this has resulted in the banking industry in Canada becoming crowded. Products have become commoditized, and while banks try to differentiate on the quality of service and on relationship management, much of the competition is price driven. This is not healthy as it drives down margins. This will force the banks to reduce expenses and seek efficiencies in order to remain profitable. They will become efficient to a point but ultimately will need to increase market share and revenues otherwise profits will begin to decline. The competitive risk is therefore *high*. We would expect that consolidation through mergers of the large banks will ultimately occur and they will look outside of Canada for growth. After this has transpired, it is conceivable that profitability will increase and the industry will return to some state of normalcy, and in turn the competitive risk will reduce.

2.3.1 Indicators of Competition

From a global perspective, there are numerous indicators of strong competition within Canada's financial sector, not only amongst the six largest bank financial groups but also with the host of other financial services providers active in the marketplace. Key indicators include access, price and choice.

2.3.2 Interest Rate Spreads

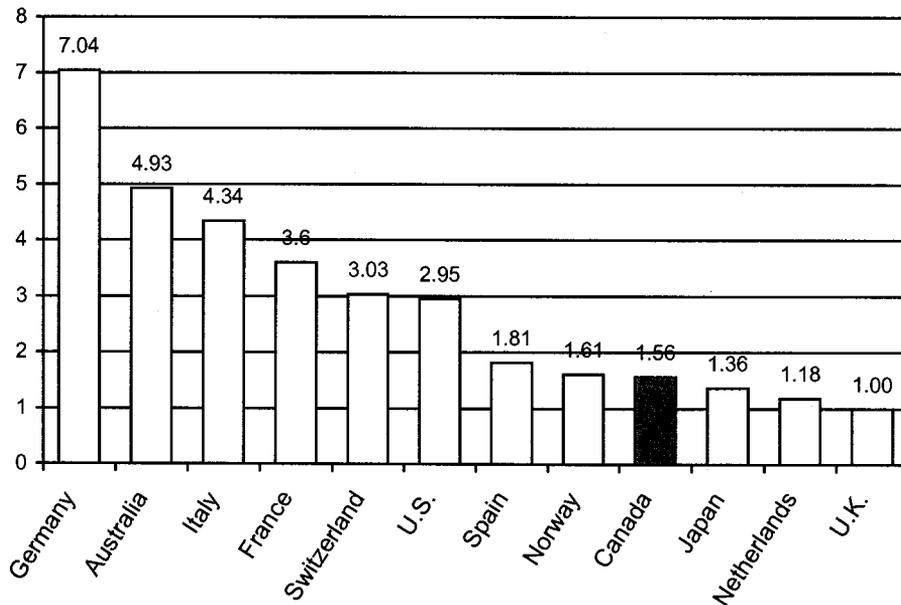
Interest rate spread is an example of price. The difference between the interest rate a financial institution charges on loans to its borrowing customers and the interest rate it pays to its depositing customers – the interest rate spread – is an excellent measure of financial sector competition. Competition results in narrowing interest rate spreads. According to the World Economic Forum's 2003-2004 Global Competitiveness Report, interest rate spreads in Canada in 2002 were among the lowest in the

Organization for Economic Co-operation and Development (OECD) countries (see Figure 2). The report shows that Canadian spreads are more than a full percentage point lower than in the U.S., almost one point lower than in the U.K., and approximately 4.5 percentage points lower than in Germany, demonstrating strong competition in the Canadian financial sector.

2.3.3 *Number of Large Competitors*

The number of competitors determines access and choice. Amongst the wide range of financial services providers in Canada are nine large full service financial groups. This is an impressive number for an economy of Canada's size. Three life insurance financial groups (Great West Lifeco/Investors Group, Manulife Financial, and Sun Life Financial) are in the top eight as measured by market capitalization, two of which are among the top five financial institutions operating in Canada (see Table 2). They offer similar suites of products and services as Canada's major bank financial groups, giving consumers a wide range of choice in their financial service providers.

Figure 2: Difference in 2002 Interest Rate Spreads in OECD¹¹



Source: World Economic Forum, *The Global Competitiveness Report*, 2003-2004.

Table 2: Market Capitalization of Financial Services Providers¹²

Large Financial Services Providers' Market Capitalization (\$ Billion at February 20, 2004)	
RBC Financial Group	\$42.1
Manulife Financial + John Hancock	\$38.4
Scotiabank	\$34.9
TD Financial Group	\$29.1
Great-West Lifeco + Investors Group	\$29.1
BMO Financial Group	\$28.2
CIBC	\$24.1
Sun Life Financial	\$21.5

¹¹ Canadian Bankers Association, *Competition in the Canadian Financial Services Sector* www.cba.ca/en/viewDocument.asp?fl=6&sl=111&tl=&docid=451&pg=1 accessed June 12, 2004

¹² Canadian Bankers Association, *Fast Facts*, *Competition in the Canadian Financial Services sector*, www.cba.ca/en/viewDocument.asp?fl=6&sl=111&tl=&docid=451&pg=1 accessed June 12, 2004.

2.4 Key Success Factors

The key success factors in this industry that emerge from the analysis using Porter's five forces model are low cost delivery and customer service. New entrants are pursuing niche markets using alternate delivery channels, products and services are homogenous, and customers have become more demanding and empowered due to enhancements to technology; therefore banks must reduce delivery expenses to continue competing on costs and at the same time provide superior customer service to stand apart from competitors.

2.4.1 Low Cost Delivery

As covered elsewhere in this paper, the banks compete on price. They are able to do so given their efficient systems in delivering services, operational efficiencies, scale, and sourcing funds at low cost. The banks are very proficient at processing transactions. According to the Government of Canada's Department of Finance¹³, in 2001 the banks cleared 4.4 billion transactions, worth over \$33 trillion. The industry processes a high volume, but earns low margins due to extensive competition, therefore is forced to develop platforms that result in low operating costs. The banks have embraced alternate channels such as electronic and telephone banking as these cost much less to operate than traditional bricks and mortar delivery channels.

Individual banks will need to continue looking for operational efficiencies. Given the large scale of operations, marginal improvement in efficiencies could result in a significant competitive advantage.

2.4.2 Customer Service

One of the few ways in which banks can differentiate themselves is to provide a distinctive level of service. Even here the barrier is high, as all banks try to compete on service. They must have a comprehensive suite of products and services; provide convenient branch locations, user-friendly online banking platforms, and a choice of alternate channels. The TD Bank for example, differentiates by providing the longest

¹³ Canadian Bankers Association, *Competition in the Canadian Financial Services Sector* www.cba.ca/en/viewDocument.asp?fi=6&sl=111&tl=&docid=451&pg=1 accessed June 12, 2004.

hours of service in its branches amongst all banks. Banks invest in customer service training, ombudsman's offices to handle complaints, and conduct frequent surveys to measure their service levels against those of their competitors.

The banks have demonstrated an ability to handle a huge volume of telephone calls and e-mails to their customer service groups and have established standards within which queries must be responded.

The banks need to keep in touch with the consumer. At TD for example, a telephone survey is conducted within 24 hours of a customer attending a branch, to determine the satisfaction level. A statistically significant sample size is surveyed, and performance metrics are tied to the results. As a follow through, those customers who rate the service below a certain threshold will be called by the Call centre to obtain specific information and determine the reason for the dissatisfaction. This is a signal of commitment being made by the bank.

Additionally, the banks will have to empower its front line staff so they have the ability to resolve customer complaints at the first point of contact, rather than refer the matter up the hierarchy, as has been the practice.

2.5 Conclusion

The purpose of this chapter was to provide an assessment of the industry, its competitive factors; key issues it faces, and its success factors.

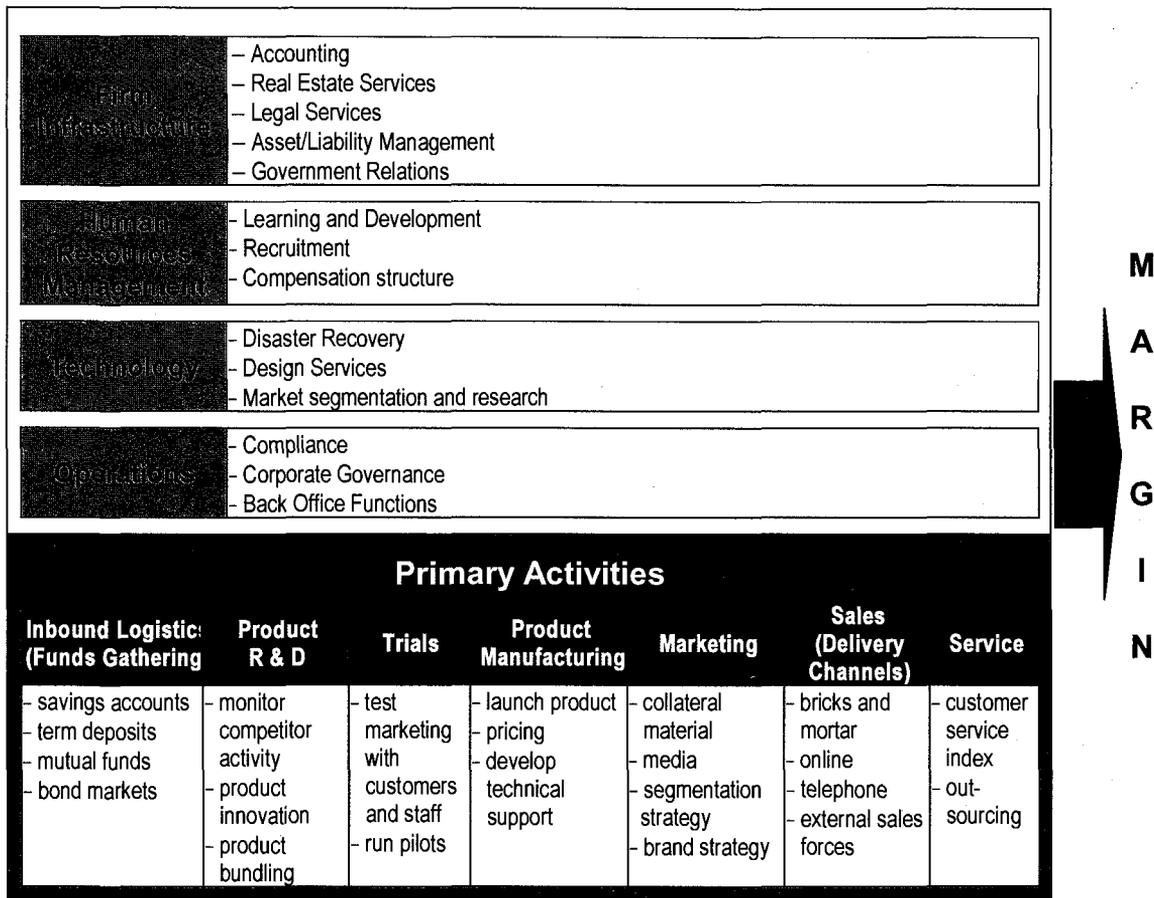
The next chapter will focus on an internal analysis of the organization, including its value chain, and core competencies.

3 INTERNAL ANALYSIS

This chapter will present an internal analysis of the value chain at TD Canada Trust, with an emphasis on areas of the bank's core competencies and where it has strategic competitive advantages.

Porter's Value Chain model shown below (see Figure 3) has been adapted to discuss how it applies to the retail distribution arm of TD Canada Trust, and specifically to its Personal Bank (referred to generically as "bank").

Figure 3: TD Canada Trust Value Chain¹⁴



¹⁴ Adapted from Michael E. Porter, *Competitive Advantage: Creating and Sustaining Superior Performance*, 1985, *The Free Press*, a division of Macmillan, Inc.

Support activities are grouped under Firm Infrastructure, Human Resource Management, Technology, and Operations. All these areas are closely linked with each other, and with the bank's primary activities that they support.

3.1 Firm Infrastructure

3.1.1 *Real Estate Management Services*

This function consists of looking for suitable locations for branches, entering into lease arrangements or outright purchase of a site and constructing a bank branch on it. This may include negotiations with private developers or property owners. They also arrange delivery of a turnkey operation to those who are responsible for managing a branch. They have to work with multiple stakeholders within and outside the bank. In addition, they provide maintenance services in all locations. In an effort to streamline their activities and maximize efficiencies, the bank has outsourced maintenance to a private company, entering into a nation wide contract. Some of the bank's employees transferred to the company as part of the arrangement, to retain familiarity and continuity.

In addition to branch locations, this group also provides services to Regional and Head office locations, data centres and other operations centres. They work closely with the Marketing group to ensure that the branding standards are maintained in all locations, with the Information Technology (IT) group to ensure adequate power and other infrastructure are provided to meet IT specifications, and with Legal Services who review all contracts and ensure appropriate insurance coverage is in place.

The site selection and development of the physical branch is a very important function. The bricks and mortar channel has the highest visual impact on the market. The branch must be in a prime location that is convenient and easily accessible. In the prevailing environment in this industry, a branch carries a significant advantage in conveying the brand message. Signage, color scheme, placement of the message (for example "Banking can be this comfortable") all form part of a branch. It has permanence, is frequented often, and even for those people that don't enter the branch, passing by it kindles a sense of familiarity. With other media that convey the brand image such as the web site, newspapers and television, the image does not remain in

view permanently. Thus a consumer may retain the message for a shorter period than that from a physical branch.

Other attributes in a financial institution that are of importance to consumers are trust and security. A permanent branch instills a sense of both these attributes. A branch conveys messages that say the bank is here to stay, and to trust it with their savings. It also signals the bank is committed to the community where the branch is located, and wishes to contribute to the success and growth of the residents of that community.

3.1.2 Legal Services

This is a very important support function and one of the foundations of a well run financial institution. Banks must have core competencies in this area. While it cannot necessarily be leveraged to competitive advantage, it is certainly an area in which incompetence could have a disastrous impact on contracts, compliance, and reporting, resulting in increased operating costs.

This group oversees all the Compliance requirements to which the bank adheres. Their involvement is wide ranging - ensuring that the mutual funds prospectuses are compliant, loan and mortgage agreements and security documentation protect the bank, account agreements are clear and comprehensive, and so on.

They support other groups such as Human Resources where they oversee employment contracts; ensuring employment application documentation meets government regulations. They assist with securities regulations, ensuring Securities and Exchange Commission (SEC) requirements are complied with, and that bank Executives trade bank shares within the 'windows' that are permitted to them.

3.1.3 Accounting

The group is responsible for reporting the bank's balance sheet and income statements, meeting the reporting timelines, publishing quarterly and annual statements as required for public companies, complying with all of the requirements of the SEC, and the stock exchanges where the TD shares trade. They also work closely with the Chief Financial Officer, supplying the data necessary to hold analyst conferences, submit

reports to comply with government regulatory requirements, and ensure that capital ratios are within Bank Act guidelines.

Working closely with Operations, the Accounting group develops and maintains the complex accounting systems that are required to manage customer transactions in the normal course of the banks daily activities. This is a threshold competency that must be developed early at a bank. Strength in this area is a minimum requirement, for which there is no substitute. Platforms of increasing complexity are built off this, but the core functions must be performed with a high degree of accuracy. Systems and processes ensure that funds are deposited and cheques are processed through the correct accounts and offsetting entries are processed so that all records are balanced. All employees that work in the branches or in processing centres process internal General Ledger entries. The group also works closely with IT, as the latter assists in automating bookkeeping processes and builds the infrastructure to accommodate the bank's daily activities.

The Accounting group links closely to the Finance group. Finance performs the planning functions, which are centralized through Head Office and are disseminated to the branch network via Regional support offices. They are also responsible for all budget preparation, monitoring and loop-back on all variance reporting. They have developed the Balanced Scorecard, which is a robust yet comprehensive instrument. It is used as a reporting tool that captures historical results, but is also utilized effectively to drive the bank's strategy implementation. The drivers are Growth in the Book of Business, Profitability, Growth in Core Banking, i.e. chequing accounts, and Customer Service. The Scorecard measures these areas and benchmarks against established targets and against other branches. Monthly rankings are provided; therefore a business unit must perform well against targets as well as against other branches. This effectively builds in currency in the reporting.

These drivers also determine part of the variable pay component of all employees. Thus the document serves many purposes and is significant, albeit evolving, with a complex accounting system in the background.

The most recent evolution that was introduced this fiscal year was the Individual Scorecard. This document is produced for every individual that generates revenue for

the bank, and measures the drivers on an individual basis – number of units sold per day, amount of revenue generated, categories in which units and revenues were recorded, and number of core accounts opened. The document provides a comprehensive statement of all components that determine the variable portion of an employee's compensation.

3.1.4 *Asset/Liability Management*

This is a Head Office unit whose primary function is to match funds received on deposit to those that are lent out. The bank matches its book every day, and all transactions of a certain size must be booked through central services, so that matching can be maintained. This is a significant activity for a bank, as the bank should not be exposed to unmatched assets and liabilities. Generally speaking, it must match all maturities on both sides of the ledger, at all times. The bank processes a significant number of transactions therefore if it were left with unmatched positions the exposure could be sizeable.

3.1.5 *Government Relations*

Being that the bank is one of the largest companies in the country and given the nature of its business, close relations with government are maintained. The bank's economists for example, often work closely with governments and share their expertise. The bank also lobbies the government occasionally, the most recent example of which was for allowing mergers among chartered banks. Relations are maintained with all three levels of government, with participation by local business units in their respective communities as appropriate. A responsible corporate citizen, the bank participates actively in the community. Its Friends of the Environment Foundation is popular for enhancing education of the environment amongst the youth.

3.2 Human Resources Management

The bank employs 40,000 people. It values its employees, as exemplified by one of the Guiding Principles: We will treat employees the same way that we treat customers. The bank conducts employee satisfaction surveys twice a year, called Pulse. This is an anonymous survey conducted through Interactive Telephone Response. To

highlight the importance of this metric, the survey's score is included in the Balanced Scorecard, and forms part of each Unit Manager's annual performance assessment review. Much work is done around Pulse, as human resource assets are highly valued and the bank needs to keep abreast of satisfaction levels. Action items are developed at each unit driven by the scores to maintain successful practices, and address those areas that could be more effective.

3.2.1 *Learning and Development*

The bank encourages ongoing education and training for all its employees. This group delivers training on any changes in compliance requirements. Courses are also provided for internal sales training, new hire orientation, new product and service delivery. The group liaises with the Institute of Canadian Bankers and the Canadian Securities Institute to stay within current guidelines for accreditation. It also facilitates training for executives, such as organizing a National Review annually to comply with mutual funds sales regulations.

This area is essential to the bank as it supports the development of core competencies among the bank's human resources.

3.2.2 *Succession Planning and Recruitment*

Succession planning is carried out all levels of the bank, from entry-level employees to executives. Planning competencies are being developed now, with processes becoming more transparent. This tool will provide a strategic competitive advantage as the industry continues to evolve towards what is presently a commonly held view that it must consolidate. A formal succession planning exercise is held at least once annually to identify talent and provide opportunities to develop it further. As the industry consolidates, it will be necessary to ensure talented resources do not depart due to lack of challenge and growth opportunities. The succession plan also identifies young employees who demonstrate potential and skill, to develop long-term leadership for the bank.

3.2.3 Compensation Structure

This group is responsible for establishing compensation scales, monitoring market pay rates, and making comparisons with direct competitors for similar jobs. They also review and make arrangements for non-monetary benefits such as medical and dental coverage.

For each position, a job description and Accountabilities and Objectives are developed. Goals are established annually, broken out by month, quarter, and year. Merit increases are granted based on performance appraisals, against a pay grid. Reviews are conducted twice a year, and the variable component of the compensation (a.k.a. bonus) is awarded based on the performance assessments and performance against targets. The variable compensation is based on individual as well as team performance.

The Compensation group works closely with IT in the development and delivery of compensation structures and in its ongoing administration, and with Finance, which determines performance targets.

3.3 Technology

Information Technology is ubiquitous in the bank. It is involved in most of the activities in the value chain, and is an essential core competency if the bank is to gain a competitive advantage.

3.3.1 Internal Design Services

Internal Design Services refers to architecture design of the bank's software and hardware IT systems. The group must ensure that the many environments that the bank operates in are compatible with each other, and information is transmitted seamlessly. Much of the information is sensitive as it contains confidential customer data. Transmission systems must be secure, using state of the art encryption tools. They must also ensure that the bank's systems and data are protected from hackers and viruses, with appropriate firewalls and continuous monitoring of activities. With 40,000 people accessing internal systems, the threat of an employee taking liberties with the

systems is omnipresent. It also manages the bank's email systems, of which there are at least three in use.

3.3.2 External Design Services

Designing sites that are accessed by external users is integral to an opportunity the bank has in differentiating itself. Users access sites to obtain information on the bank – statistical data, the vision statement, bank operations and core businesses, economic research, forecasts, presentations, publications, market data, market commentaries from experts in matters related to money, economics, and banking.

Key attributes for the online banking site for consumers include number of clicks to access the site, ease of use, functionality, and layout. There are certain standards that do not provide competitive advantage but must be met as a minimum expectation; for example, the site must not be down for reasons such as maintenance requirements, must always be available and supported, and have basic functionality. Beyond that, while technology evolves and banks develop stronger competencies, there is an opportunity for differentiation. Opportunities exist in providing consumers with an ability to perform more transactions online, especially more sophisticated transactions that are leading edge and which competitors have not yet developed the capability to provide. Some recent introductions by TD Canada Trust include the ability to "E-mail" money, which is to transfer funds to 3rd parties whose accounts are at TD. This is a first generation service in which the 3rd party must be willing to provide account information to the remitter in order for the transaction to take place. It is envisioned that future generations of this service will enable emailing funds to parties who deal with any financial institution across the world. This will replace the conventional method of wiring funds and likely at a fraction of the current cost.

Another differentiator is providing access to an alternate channel in conjunction with the online channel. At TD, Call Centre operators are available 24/7/365. If a consumer is unable to conduct a transaction online, the option to talk to a customer service representative is available. The bank would be well served by prominently displaying the e.bank Call Centre number so an online customer can comfortably access this channel, avoiding any potential frustration.

With the advent of Voice over Internet Protocol (VOIP), early adapters to this technology may be in a position to gain a competitive advantage, albeit its performance should be monitored closely since the experience with new technology is that firms can enjoy late mover advantages from systems debugging and a reduction in costs of acquisition and implementation.

With increased adoption of the online channel and improving functionality made possible by enhancements to technology, the banking industry in Canada will become even more competitive. As the major chartered banks develop competencies in the online channel, improve operating efficiencies with technology, and increase scale in their operations, they will look to add customers to benefit from low marginal costs.

As technological enhancements occur at a rapid pace, competencies will have to be developed in evaluating which to implement, study returns on the investment, determine how it compares to that being installed by competitors, particularly new entrants that often use technology more aggressively out of necessity as they don't have an established presence through a branch network.

3.4 Operations

This support function carries the responsibility for developing rules, regulations and operating procedures that are implemented across all business units and in bank branches. It is essential that procedures are standardized and applied consistently in all areas of the bank. This uniformity increases efficiencies, and ensures that clients have the same experience at points of contact. Standardization is also important in an organization with a large employee base, for the staff to have certain levels of expectation, and to accommodate transfer of human resources between branches and business units with minimal disruption.

Operations are a core competency for a bank. In a business that follows a cost based strategy, Operations is very important as it has a significant impact on costs. Many efficiencies and synergies can be derived from Operations, which will drive down costs and provide a strategic competitive advantage. Examples of efficiencies include reducing the number of documents that must be filled out during an account opening

process; empowering front line staff to resolve customer complaints when first presented; and pre-populating information to reduce manual input during a transaction.

An area in which Operations should develop a competency in is that of customer education. In developing processes Operations managers should educate customers in the use of services that customers have acquired from the bank. For example, if the messaging on customers' account statement encourages them to use online banking, the statement should indicate how to use the service once they have signed up for it.

3.4.1 Compliance

The nature of the banking business is such that it demands perfection. Activities are subject to many rules and regulations. Under the Bank Act, the federal government requires certain regulations to be met. There are numerous regulatory authorities that the bank must satisfy, such as the Office of the Superintendent of Financial Institutions, The Investment Dealers Association, The Canada Deposit and Insurance Commission, and the SEC. Consequently, operations in the bank have compliance built into its processes. Double verification of all documents and transactions is required. Routine operating procedures are subject to a formal Audit typically once a year by the bank's internal audits team. Ongoing "surprise" audits are undertaken, with formal feedback to the business units. Internal Practices and Processes are weighted in individual performance appraisals.

Compliance is carried out daily in each business unit; consequently competencies are widespread. Daily verification is done for Mutual Fund transactions to ensure sales are within client risk tolerance levels and investment objectives; Credit compliance confirms that lenders process loans within adjudicated terms, conditions and amounts; Account opening verification is done to ensure customers are placed in suitable products and proper identification is obtained so that customers are known to the bank and chances of fraudulent account openings are reduced.

3.4.2 Corporate Governance

Governance guidelines are established in conjunction with Legal department and the CFO, including those for Executives and the Board of Directors to ensure the bank is governed within prevailing standards for public corporations. All staff is subject to

governance, and is required to report any abuse or inappropriate conduct. Staff files annual statements confirming that they understand governance policies and practices.

3.4.3 Back Office Functions

Back office operations include Data centres; Cheque clearing services; Branch Services Centres that process cheques and deposits, and verify general ledger entries; and Credit Administration Centres that prepare and register security documentation. Such centres are located in several cities, and with the advance of technology, are increasingly automated. This will ultimately result in fewer centres, and less manual intervention.

In conjunction with Operations, the bank has a core competency in back office functions. It can leverage this competency by improving efficiencies in these transaction-processing activities, reduce costs and gain a competitive advantage. Accuracy in transaction processing also reduces costs.

3.5 Primary Activities

These activities include Inbound Logistics, Product Research and Development, Trials, Manufacturing, Marketing, Sales, and Service.

3.6 Inbound Logistics

Inbound Logistics represents the funds gathering process. Banks gather funds that are in turn lent to customers. Offering savings accounts and other investment vehicles such as term deposits raises funds. Another source is the float that becomes available – when customers maintain funds in their chequing accounts for the purpose of paying for transactions that they carry out in the normal course. While the cheques are in transit (in the mail, or in the clearing system), the bank has use of the funds. Bond markets are another source; monies lent for residential mortgages are raised through the bond markets, particularly for long-term mortgages where it is necessary to match maturities. Overnight requirements can be met through central bank financing.

3.7 Product Research and Development

Products in the banking industry are largely homogeneous. There is little to differentiate the banks, given the highly competitive environment they operate in and their capability to quickly duplicate products. Therefore, a bank must continually innovate and modify its offering. As part of R&D activities, the bank monitors competitors' products. It also offers a variety of bundles to create a lock in effect so that a customer will resist switching banks. Bundles include Select Plans for example, consisting of a chequing account, a Visa Elite card, a Safety Deposit Box, and access to PC Banking (EasyWeb) for a single monthly fee.

R&D also covers online and telephone banking. An increasing number of services can be performed online and via automated teller machines. Advances in technology will continue this trend, providing more convenient access points for consumers. According to a benchmarking study by Boston Consulting Group in 2003,¹⁵ customers who regularly pay bills online are about twice as profitable as other account holders. Therefore, those banks that have figured out how to drive customer adoption of online bill payments have a measurable competitive advantage in financial services. And according to the Institutional Investor¹⁶ their survey of bankers in the United States indicates benefits extend beyond cost reduction. Once clients register online with their core chequing account, they tend to maintain bigger balances, use more services and stay loyal to the institution longer than off-line customers. That results in increased profits.

It follows from the above findings that a bank should seek ways to have customers adopt online banking and make more services available online to increase its appeal.

¹⁵ Wade D. Cook, Lawrence M. Seiford, Joe Zhu, *Models for performance benchmarking: measuring the effect of e-business activities on banking performance*, Omega (Oxford); August 2004, Vol.32 Issue 4, p313.

¹⁶ J. Kutler, Bank Shot, *Institutional Investor-International Edition*, September 2003, Vol.28, Issue 9, p151.

3.8 Trials

The bank conducts trials through test marketing and through surveys conducted internally and by outside research companies. The latter is done in a few locations where a product or service is piloted. Trials include testing consumer acceptance and adjusting as necessary. In addition, new procedures and guidelines are written for sales staff, and feedback obtained from participating staff on the procedures, ease of administering the sales process, and the product itself. Pilots typically run for two months.

3.9 Manufacturing

Once a trial is successful, the product is finalized and readied for launch. Often, the launch is managed over a two-month period, rolled out one region at a time. Technical support and training is organized for the staff, in conjunction with the Learning and Development centres and the IT group. Product pricing is established along with compensation levels to the sales units.

3.10 Marketing

This unit arranges marketing materials such as posters, brochures and other collateral to support sales activities and attends to advertising in the media. Research is conducted on demographics, market segmentation, and consumer trends and supplied to the Product groups for use in product development, and to the Sales channels. The group works closely with IT in developing strategies, such as the Financial Planner Strategy of targeting high net-worth clients that are more profitable to the bank due to their more sophisticated requirements.

3.10.1 Brand Strategy

Marketing is also responsible for the brand. Given the high degree of competition in this industry, branding is one of the key differentiators.

When TD and Canada Trust merged, it provided the organization the opportunity to re-brand itself. They started by renaming their various businesses, and applying a

consistent look, colour scheme, and logo. All business units are now preceded by the letters TD; for example TD Waterhouse, TD Commercial Banking, and TD Private Banking. It is interesting that other banks have taken the same approach. Royal Bank for example, recently altered their logo, and RBC, as in RBC Dominion Securities or RBC Life Insurance, now precedes their businesses.

TD has adopted a powerful, distinctive customer experience based brand. Its aim is to leverage this superior service into better retention, attraction, and increased business with each customer. TD Canada Trust differentiates itself by promoting its extended hours, which is a strategic competitive advantage. The bank's tag line is "banking can be this comfortable". Behind this message is a whole structure built around commitment to customer service.

In order to deliver on the brand message communicated to the market, the bank expends considerable resources in explaining the brand strategy to employees. This is designed to develop a core competency, and to leverage this competency into a competitive advantage. Employees are educated on what a brand strategy is, its value, why the specific strategy was selected, the vision behind the brand, the guiding principles in carrying out the brand strategy, and how to put the "comfortable experience" into practice.

Support structures are built around the brand, for example; outsourcing the installation of consistent signage at all points of contact, ongoing monitoring of the signage, guidelines around use of the company logo, centrally controlled advertising, telephone scripting particularly for the Call Centres, and training the Customer Service Representatives on service attributes.

3.11 Sales

Sales are conducted through several channels. Consumers expect banks to have multiple channels. Those that integrate and excel in all channels can have a competitive advantage.

3.11.1 Branch Network

This is the traditional bricks and mortar channel that has been the staple of the larger banks in Canada for decades. The bank has branches in appealing locations across the country, with which consumers are familiar and comfortable. They convey a sense of security to consumers, and are a source of competitive advantage and in the past a barrier to entry. The branches house the direct sales force – Financial Advisors and Financial Services Representatives – and the tellers. Automated Teller Machines are often situated at branches. These machines can perform most of the services that tellers can, but are not yet used for sales functions.

3.11.2 Online

The bank's EasyWeb service is its online channel for sales and service. This channel is becoming increasingly popular, and is growing faster in usage than the telephone channel. Initially consumers used this for its enquiry capabilities only, however as encryption systems improve and consumers acquire compatible hardware, they are becoming comfortable in making product purchases online. Sales include loans and mortgages, bank accounts, term deposits, mutual funds and Visa cards. This is the least expensive distribution channel for the bank, and in time is expected to be one of the primary delivery vehicles.

The Internet represents an area of opportunity for the banks to create a differentiating customer experience. The banks' investment in building an online channel will yield dividends in the long run as nearly half of the U.S. population aged between 35 and 44, and more than half of the 18-to-34 year olds will use online banking by 2007. In addition, the availability and perceived quality of an online presence matters even to those customers who won't be taking advantage of it. Banks that stay behind the curve risk losing not only their credibility but also market share from customers who have never used online banking.

During the Internet boom many felt the online channel would take over all channels. But according to David Schehr, a researcher with Gartner G2, "...it is a myth in the industry that consumers substitute new channels for older ones. It never works out that way. During the 1970's and 80's, ATMs were considered a silver bullet. Soon enough tellers and branches would be history. In the decade that followed, call centres

and phone banking were widely believed to have the same effect. But in reality the total number of branches has slowly crept up over the last 15 years.”¹⁷ In fact, people supplement channels, taking advantage of the benefits of a new channel while still relying upon the established channels for their particular strengths.

3.11.3 Mortgage Sales Force and External Mortgage Brokers

With the proliferation of mortgage specialists, the bank now has its own sales force that sources mortgage business. The bank also has arrangements with external brokers to source business and places it in the branch network for servicing. Consequently, mortgage origination at the branch level is not a core activity. Instead, once a client is introduced, the direct sales force increases the share of the client’s wallet. Therefore these two sales forces complement each other with their respective core competencies to create a competitive advantage.

3.11.4 Indirect Sales Force

Through TD Greenlight Financial Services, the bank provides auto financing through dealerships. Also, external Financial Planners and Investment Advisors sell the banks proprietary mutual funds.

3.11.5 Telephone

The EasyLine service was launched before the online service. It has higher usage than online but is rapidly losing ground. Enquiry and basic functions are automated; however sales functions require manual intervention. Therefore the bank is not promoting this channel aggressively, and is not investing in improvement of its infrastructure.

The Telephone channel includes IVR (Interactive Voice Response) and the Call Centre. The bank has consolidated all call centres into a single location in London, Ontario, from where they service calls across the country. They operate on a 24/7/365 basis to handle customer enquiries, and make proactive sales calls to target customers

¹⁷ Marc E. Babej, Web’s Real Value is as part of Multichannel Environment, *American Banker*, August 2003, Vol. 168, Issue 152, p6.

that have been identified by the Marketing group. This is an efficient sales channel as the learning curve is rapid with the concentration of expertise in a single location. Overhead costs are lower as the location is not open to the public, and product fulfillment is online.

Opportunities exist to drive down costs with the labour component concentrated in one centre, and utilization of technology in online operations.

Many firms outsource their Call Centres to foreign countries such as India to gain a competitive advantage by reducing costs. TD has not done so likely due to its promise to the government as part of the merger with Canada Trust to retain operations and employment in London, where Canada Trust had a base of operations.

The bank has slowed investment in upgrading the IVR service, as its usage has declined in recent years. Consumers are rapidly substituting that service with the online channel.

3.12 Service

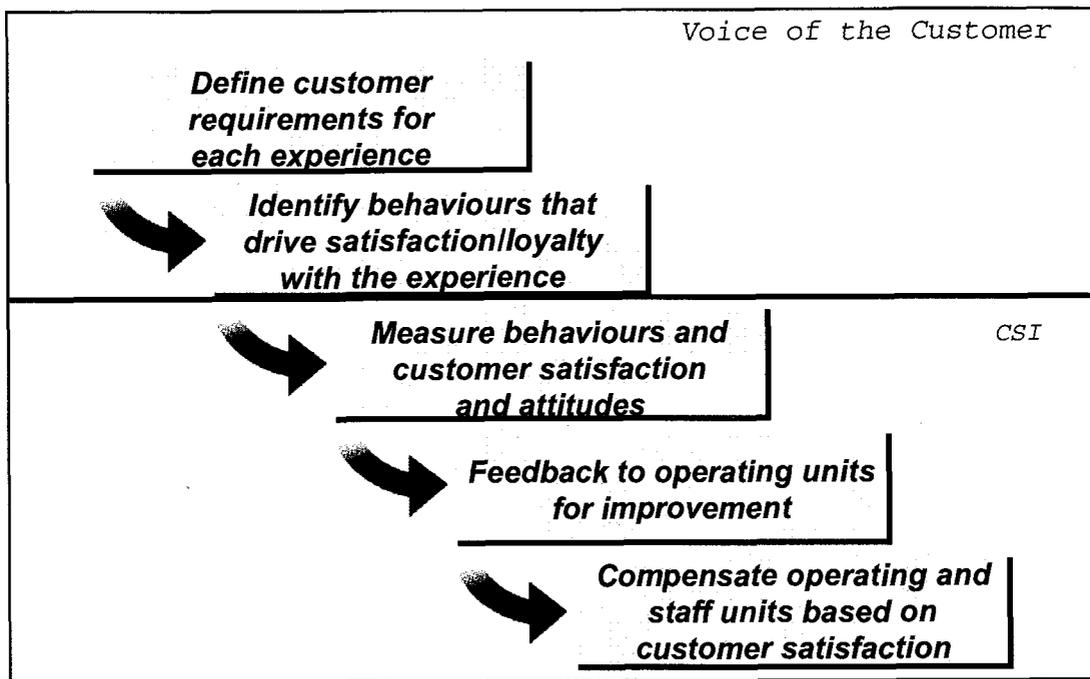
Given the competitive environment in banking, the ease with which consumers can switch banks, and product homogeneity, the bank must provide a high quality after sales service. Relationship managers are supported in their efforts by having seamless processes in the background through the back room functions. The bank is increasingly outsourcing some of these services. This is necessary to squeeze out margins from operations since banks compete on price. In order to be a cost leader, efficiencies must be located in operations. After the merger of TD and Canada Trust, the bank conducted an in-depth review of all its processes, and has consequently outsourced its filing to Iron Mountain, cash pick up and delivery to Securicor, data centre operations to Symcor, and cheque processing to Intria Services Inc.

The bank also pays close attention to the quality of service provided to its customers at every point of contact. High service standards and benchmarks are adhered to. An external company conducts customer surveys daily, with Customer Service Index (CSI) scores returned for measurement against targets. Behaviours measured on the CSI are derived from Voice of the Customer research, and are what

customers say impacts their overall satisfaction with the service that they receive. The CSI score is part of employees' annual performance assessments and is one of the metrics in the variable component of compensation.

The delivery of high quality service ties in to the company's brand. As seen in the chart below (see Figure 4), Voice of the Customer surveys drives service behaviours. The bank out sources these surveys to obtain an unbiased assessment of customer satisfaction drivers.

Figure 4: Customer Satisfaction Model¹⁸



3.13 Conclusion—Value Chain

The bank's activities do not operate in silos. There is constant overlap and loop back to the various activities in the value chain. The bank has core competencies in operations and compliance functions. Efficiencies are available in routine, process

¹⁸ Adapted from Chris Armstrong, Executive Vice President and Chief Marketing Officer, TD Canada Trust, *New Directors Orientation*, January 23, 2004, Toronto, Ontario.

driven activities, offering competitive advantages. To squeeze further cost savings, many functions have been outsourced, and the bank will continue to look for opportunities to outsource more. Core competencies are being developed in sales functions and utilization of technology to gain competitive advantage. With continued innovation in IT, the bank provides high quality service through customer experience based branding and Customer Relationship Management competencies.

To manage the tension between providing high quality service within a low cost generic strategy, it is important to constantly monitor and evaluate that cost reduction activities do not damage customer service. The bank has developed a core competency in measuring and interpreting customer service levels, and it will have to carry this further by expanding these competencies into measuring the impact of new initiatives quickly and making adjustments to ensure service quality remains superior and customer expectations are met.

3.14 Strategic Fit

The bank follows a cost-based generic strategy, but leans towards differentiation when it can be achieved in a low cost paradigm. The table below (see Table 3) rates the strategies in various key criteria between the generic strategies: cost-based (low cost/adequate quality) and differentiation (high quality/ adequate cost).

Table 3: Generic Strategy Ratings for TD Canada Trust¹⁹

Criteria	Strategies											
	Cost Based	Rating Scale										Differentiation
	(Low Cost / Adequate Quality)	1	2	3	4	5	6	7	8	9	10	(High Quality / Adequate Cost)
Product Strategy	<i>Rapid Follower</i>					X						Innovative
R&D Expenses	<i>Low R&D</i>				X							High R&D
Structure	<i>Centralized</i>	X										Decentralized
Decision Making	<i>Less Autonomy</i>		X									Autonomy
Manufacturing	<i>Economies of Scale</i>	X										Economies of Scope / Flexible
Labour	<i>Mass Production</i>		X									Highly Skilled / Flexible
Marketing	<i>Comparative - Push</i>							X				High Cost / Pioneering / Pull
Risk Profile	<i>Low - Risk</i>	X										High Risk
Capital Structure	<i>Leveraged</i>									X		Conservative

3.14.1 Product Strategy

The banking industry in Canada is concentrated amongst five large banks that have the bulk of the market share. As such, the banks are able to easily and at a fairly low cost monitor each other's activities and quickly adopt any new product introductions or enhancements. Consequently there are very few differentiators in products amongst these larger chartered banks and first mover advantages are miniscule. Several smaller banks also exist, and while the larger banks monitor their products and activities also, currently the smaller banks do not have as much of an impact on market share or influence on behaviour of the mass market.

¹⁹ Adapted from template by Dr. Ed Bukszar, Simon Fraser University, supplied to EMBA class, January 2004.

Because of the homogeneity in products and the highly competitive nature of the industry, TD's product strategy is rated in the middle of the grid. The bank continuously innovates – a good recent example is its Home Equity Secured Fixed Rate Mortgage. This product enables a consumer to establish a credit facility with maximum flexibility built in. It is a combination conventional mortgage with fixed rates and repayment terms, and a flexible line of credit that the consumer can use at their convenience, with optional repayment schedules. This product was duplicated within a month by all other banks, and presented under varying names. Therefore, while the banks are innovative, they must also be rapid followers.

Banks are recognized as leaders in the industry so the market has an inherent expectation they will innovate and not be perceived as perennial followers. While a follower approach may have economic merit, patrons would not view this favourably.

The banks differentiate themselves in the delivery and implementation of their products and services. The TD Bank focuses on an integrated offering that contains the bank's value proposition for its clients. For example, its core banking accounts are styled "Everyday Banking". These are a suite of products that combine a chequing account, access to ATM's, EasyLine, and EasyWeb. A self-serve offering is priced at \$3.95 per month, and includes a specific number of transactions. Teller service is available at additional cost. Another suite is offered at \$24.95 per month, containing unlimited access to in-branch Teller service, ATM, EasyLine, EasyWeb, Safety Deposit Box rental, no-fee Traveller's Cheques, and Elite Gold Visa Card with no annual fee²⁰.

In order to simplify the selling process for sales staff, the decision process for the consumer, and contain costs of delivery and marketing, only 4 such suites are offered.

The product offerings are based upon research on the bank's "Comfortable Experience" brand. The research determines the attributes that drive comfort for consumers, and which suite best provides a pleasant experience for a customer.

²⁰ TD Canada Trust, *Product Brochure*, May 2004.

3.14.2 R&D Expense

The retail business is stable, with benefit of years of historical data and experience. This category includes costs for daily customer service surveys, periodic consumer focus groups, Voice of the Customer research that measures performance against other banks, as well as R&D expenses on development of new products and services. Much of the research is outsourced to independent third party professionals. Because this is a stable business, R & D requirements are in the lower mid range, hence a 4 rating. Recall also that the bank often simply follows the lead of competitors; therefore it is not always necessary to invest in all the new products introduced.

R & D expenses include research on process improvements in the bank's off site processing centres (BSC and CAS), physical branch locations, layouts, customer routing flows, IT systems enhancements, and so on. After the merger with Canada Trust, TD amalgamated the systems and processes of the two companies. An in depth review of all of its equipment, processes, and product and service offerings was undertaken, which led to a complete revamping and streamlining of a multitude of processes. For example, the bank entered into a contract with Intria Services Inc. to outsource processing of all of its routine cheque clearing function. This includes verification of cheques, returning cheques with insufficient funds, placing/releasing holds on funds deposited through the ATM's. As the key decisions for these processes remain with the bank (Intria is only responsible for implementing these decisions), systems were built to automate most of these decisions within certain parameters, and communication channels established.

3.14.3 Structure

The company is highly centralized. All key decisions that involve policy, product development, learning and development curricula, branding, systems enhancements, etc. are made at Head Office. The Regional offices are known as Support Offices, and are involved in implementing decisions made at Head office as well as supporting the branch network, which delivers services to the customer.

One of the attributes that drive a comfortable banking experience is consistency at every point that the customer comes in contact with the organization. This could be in the branch channel, online, on the telephone, or in the media. To leverage the bank's

national reach and enhance the TD brand, it is important that the whole bank operate under similar guiding principals, advertising, promotions, credit granting criteria, service delivery standards, product pricing, and so on. If their experience is not consistent, the bank would end up with customers that would in fact be clients of a particular *channel* and not necessarily TD clients.

In its research after the merger with Canada Trust, the bank found that it was not uncommon to have customers deal with the bank because they had a relationship with a particular branch. The bank has since made a concerted effort to leverage its brand. We still find customers that deal with the bank because they enjoy good relations with certain people that serve them in their branch, not recognizing the support structure that exists in the background. The value of personal relationships is a potential threat to the bank: as electronic banking becomes more prevalent, the bank provides increasing capabilities to the consumer for more self-serve transactions. This reduces the reliance on human interaction for personalized service with the branch channel. It is conceivable that consumers may become less satisfied with certain services, and because they are dealing with the bank online, feel freer to shop at and choose from competitor's online offerings. The Internet has created an empowered consumer.

3.14.4 Decision Making

With the advent of enabling technology, decision-making has become largely centralized. To utilize loan requests as an example, branches no longer have discretionary lending limits. All requests are submitted online, and routed to an adjudication centre. There are two such centres in Canada, with specialists concentrated in these units. Consequently they become very competent in their area of expertise. Turn around time on credit requests is very quick (the standard is four hours), as the approval centre operates in a mass production environment. This reduces labour costs, improves efficiencies, supports the sales channel's performance with reliable and quick responses, and improves customer satisfaction.

Other functions work similarly. The bank has outsourced daily maintenance of premises. For any requirements such as janitorial services, replacing lights, etc. the branch reaches a Help Desk through a single contact point.

The types of decisions made at the branch relate to performance assessments of staff, action plans in response to bank initiated sales campaigns, and implementation of customer service programs. Many day-to-day operating decisions are made at the branch in the normal course, but strategic decisions are centralized. This fits a cost based generic strategy.

3.14.5 Manufacturing

Manufacturing refers to 'back room' operations, which are carried out by Credit Administration Centres and Business Services Centres. They support the sales channels by performing the administration such as preparing loan and account documentation, liaising with solicitors who prepare security packages, liaising with the cheque clearing company, handling estate files, and so on. This is a mass production set-up that employs 400 people per centre. Processes are regimented, with communication protocol in place. They follow up on any missing items from the branches, under prescribed timelines. Deviations are escalated to management for handling. With such large-scale volumes a rigid structure is necessary. Fast, efficient and seamless processing is vital, in order to benefit from available economies of scale. Were flexibility introduced, costs would rise, defeating the purpose of these mass production facilities.

3.14.6 Labour

Each retail branch is comprised primarily of Service staff (tellers) and Sales staff (Financial Advisors). They operate in a high volume, transactional environment. A teller handles 130 transactions per day on average²¹, or one transaction every 3.5 minutes. The process and equipment to perform the transaction is very efficient. The teller must ensure that the customer's needs are met and that they have a comfortable experience.

Each salesperson processes 9 client requests per day²² on average, or one every 50 minutes. This includes a variety of transactions such as a new mortgage or loan application, account opening, Visa sale, safety deposit box rental, etc. The

²¹ TD Canada Trust, *Operational Excellence Report*, December 31, 2003.

²² TD Canada Trust, *Individual Scorecard*, December 31, 2003.

complexity of each request varies, but the process must be designed so that it is not cumbersome and the request can be fulfilled with minimal chance of error. To improve efficiencies, all clients with needs that require customized solutions are referred to other areas such as TD Waterhouse, to be serviced by specialists. Straightforward, transaction oriented services are performed in the branch channel. Similarly, the online channel is designed for transactional service, albeit its capabilities are becoming increasingly sophisticated; and the Call centres are focused on sales and service required by the majority of consumers. As a result of simplifying the offering at the branches and the Call centres, information asymmetries is lessened, as both consumers and employees are well informed on the bank's products and services. The employees develop competencies in enhancing customer relationships by receiving training and coaching on the attributes that drive comfort in a customer interaction such as Quick Service, Empowered and Effective Staff, and Makes you feel Appreciated. Efficiencies improve as employees become proficient at their jobs, consequently reducing costs.

At the Call centres, efficiencies are measured in terms of minutes per phone call. A balance must be maintained between retaining high quality service standards, and efficiency in handling calls. A cost based strategy cannot overlook the need for high service standards in an industry that is very competitive. The bank therefore pursues a strategy where adequate quality is fairly high.

3.14.7 Marketing

The industry is highly competitive. Consumers have many institutions to select from, switching costs are low, and products and services tend to be homogenous. TD Canada Trust separates itself from the competition by providing a comfortable banking experience for consumers. It has undertaken considerable research to determine what "*Comfortable Experience*" means to customers. To illustrate, one such attribute is Convenience. This translates into flexible hours. As tangible evidence of the bank's credible commitment to this comfort driver, branches are open from 8 to 8. Brand messaging is built around this. This includes advertising through the print and visual media, in-branch collateral, community activities, web casts, and so on. Related costs are high, and a pull strategy is employed. This category is therefore rated 7.

3.14.8 Risk Profile

The bank's retail business is based on a high volume, low margin strategy. It is a proven strategy that generates a steady and reliable stream of profits, which is reflected in share price. Inherently the bank must maintain a low risk profile, as it cannot expose itself to undue risk by venturing into high-risk undertakings. It is also important for consumers to have complete trust in the financial institution, which also necessitates a low risk profile. If the bank became involved in high-risk activities, consumers would fear losing their savings that they entrust to the bank. The bank deals primarily with low risk clients, and refrains from aggressive lending. It has strong competencies in monitoring asset risk, with ongoing audit of all transactions, compliance with policies and regulations, and has a culture of strict discipline.

3.14.9 Capital Structure

The bank's goal in managing capital is to "provide enough capital to maintain the confidence of investors and depositors, while providing shareholders with a satisfactory return"²³. The Office of the Superintendent of Financial Institutions Canada (OSFI) establishes measurement standards for the banking industry. Target ratios for Tier 1 and Total Capital are set at 7% and 10% respectively. TD's ratios are well above the targets, at 10.5% and 15.6%²⁴. The banks are also required to maintain a reserve ratio, which restricts them from lending out all of the funds that they accept on deposit, and are very closely monitored by OSFI.

3.15 Conclusion—Strategic Fit

The strategy is based on low cost, but quality is high. The industry is currently in a state where a low cost/adequate quality strategy is transitioning to high quality, yet competitors must remain low cost producers. This position is subject to threat from both ends.

²³ TD Bank, *Financial Group Annual Report*, October 31, 2003, page 42.

²⁴ TD Bank, *Financial Group Annual Report*, October 31, 2003, page 42.

A pure low cost strategist could enter the market and peel off share. ING Bank is a good example, as it is pursuing just such a strategy. The channels available to them determine their positioning. Their basic model is to offer limited distribution channels: online and telephone. They are not interested in building a branch network. Entry costs of infrastructure development alone would make this prohibitive. Competition in that arena is too steep, as the well established chartered banks have captured that share of the population, which prefers the bricks and mortar distribution channel. Working within the online and telephone channels, ING keeps its offerings simple. Their stated objective is to strive for maximum efficiency at the lowest possible cost²⁵. They offer mortgages and core bank accounts (i.e. savings and chequing accounts required for daily banking). Their proposition is to offer the best value for money, and heavily advertises its flexible high-rate, no-fees, no-minimum single account on which clients can issue cheques and earn rates of interest equivalent to a term deposit. They also offer an aggressively priced mortgage with extensive prepayment options, and advertise it as a no-haggle rate alternative that is better than the competition. According to Brad Francis, Manager, Marketing Research and Customer Care at TD Bank Financial Group, one of the attributes that customers value highly according to the Voice of the Customer research is "The bank gives you more for your money". ING uses this attribute in their advertising, and not in-coincidentally, received the highest possible rating in this category.

ING Bank launched its Canadian operations in April 1997. By December 2000, they had acquired over 400,000 Canadian customers, with over \$4 billion in assets. At December 2003 they had 850,000 clients, with \$12 billion in assets. While this is small compared to the Big Five chartered banks, ING has grown three-fold in the past 3 years, and is now bigger than the largest credit union in Canada, Vancity Savings Credit Union, which has assets of \$9 billion. ING has entered the insurance business as well, and is one of the largest providers of general insurance with over 4 million individual policyholders in Canada²⁶. And according to the Canadian Insurance Annual Statistical

²⁵ ING Group, Report of Executive Board, *Annual Report, 2000*, <http://press.ing.com/en/index.html>, accessed May 14, 2004.

²⁶ About ING Canada, 2004 www.ingcanada.com/en/ing_glance.html accessed June 27, 2004.

Review for 2003, ING is the largest Property and Casualty insurer in Canada with \$7.3 billion in assets.

Similarly, MBNA Bank has penetrated the credit card business in Canada with an aggressive and incessant mail campaign, and is gradually taking away share from the chartered banks.

These two banks do not publish profit figures for their Canadian subsidiaries and it is conceivable that they are not yet profitable, but they are both very large institutions that can sustain start up losses to gain a foothold in the market.

To defend against this, TD must continue to drive down costs across the organization. At some point it will run out of options to do so, but for now opportunities exist in out sourcing routine activities and consolidating back room operations. The online channel offers the highest potential for efficiencies in distribution, as marginal cost of delivering products and services is minimal in that environment. The bank should therefore continue to encourage customers to convert to the online channel, thus driving down operating costs and share the savings with the rest of the enterprise.

At the other end of the spectrum, companies that pursue a High Quality/High Cost strategy also capture share in the upper end of the market. Banks provide basic transactional services and lending products that rely on scale rather than high margins to produce profit. From that base they transition eligible customers to higher margin fee based wealth management products such as financial planning, mutual funds or investment brokerage. This high-end market can earn a return of 30% or more²⁷. Boutique firms such as Phillips Hager North cater to this end of the market. They offer a range of products from the plain vanilla to more sophisticated. Clients that are less risk averse can be lucrative as they invest in the latter vehicles. And firms such as Edward Jones provide personalized service with broker-owner operated offices that specialize in safe investments for the long-term investor. Their products are primarily low volatility mutual funds and blue chip equities.

²⁷ Big 5 Fight for \$1 Trillion Security Blanket, *Globe and Mail*, Report on Business, June 2004.

To combat the erosion of share at the top end, the TD Bank has launched a Private Client Centre (PCC) strategy. Clients with \$100,000 or more in investable assets are referred from the branch channel to a PCC. These units employ Financial Planners as well as Investment Advisors (Brokers) who have the qualifications to better service the needs of such clients. This strategy pre-empts clients from moving assets to boutique investment houses. PCC staff also proactively pursues wealth that is being accumulated by baby boomers.

3.16 Culture

The TD Bank had traditionally been bottom line oriented. It had established a reputation for forward thinking in the Securities business, having been a leader in lending into the cable industry when it was in its infancy and the foresight to build a discount trading operation and creating a market in self service trading in Canada. These businesses produced volatile returns however. Canada Trust on the other hand had a reputation for quality service, steady earnings and a focus on retail banking. While this did not produce stellar returns given the competitive environment and the nature of the business, the operation was predictable and profits were consistent, which shareholders valued.

When TD and Canada Trust merged, the bank adopted Canada Trust's approach. It has focused on competing largely in the domestic retail banking industry, enhancing shareholder value by providing predictable earnings, and removing volatility by reducing activities in corporate lending and in the Securities business. Its target is to earn 80% of its profits from the retail business, compared with actual profit of 77% in 2003, and 70% in 2002²⁸.

TD Canada Trust's value proposition is to deliver superior customer service. The culture has consequently changed during the past 3 years. Whereas in the past, employees had some autonomy, authority is now centralized. This is necessary in order to provide a consistent service experience at every point of contact. Branches now have the same look, the branding message is delivered at every opportunity, credit

²⁸ Report on Business, *Globe and Mail*, June 2004, page 43.

adjudication authority has been moved to automated scoring systems or central approval centres, advertising is managed centrally, telephone answering is scripted so that the responses at Call centres and branches are identical. The deal making, bottom line oriented culture has been replaced with a softer customer service bias, and a focus on delivery of centrally designed programs rather than those initiated by individual operating units. Consequently people are not as challenged in the present environment, which becomes an issue. Retaining talented employees and keeping them motivated is more difficult. Through turnover and buy in from employees, a new culture is evolving, and fits the strategy the bank has adopted.

3.17 Financial Analysis

The Royal is the largest bank in terms of assets, shareholder equity and profitability (see Table 4). TD was the fifth largest by asset size for many years, until it acquired Canada Trust in 2001, at which point it vaulted into second position. With subsequent consolidation of operations and attack from competitors, assets dropped for consequent years, and now the rest of the Big Five are relatively similar in size, ranging from \$256B to \$285B. The Royal has a good franchise in Canada, which provides a steady increase in business volumes, and it has also grown through acquisitions in the United States.

Table 4: Key Financial Measurements of Big Five Banks in Canada

Bank Name	Year ended	Total Assets (\$millions)	Net Income	Shareholder Equity (%)	% Growth in Assets
RBC	2003	403,185	3,005	10.21	6.74
Scotiabank	2003	285,892	2,477	10.90	-3.54
TD Bank	2003	273,532	1,076	8.27	-1.62
CIBC	2003	277,147	2,063	10.99	1.41
BMO	2003	256,494	1,825	10.03	1.44

Other domestic banks include National Bank of Canada, whose assets at October 31, 2003 were \$82B, Laurentian Bank with \$16.7B, and Canadian Western Bank with \$4.3B. TD acquired the assets of Laurentian Bank in the spring of 2004.

Within the non-branch delivery channels, online banking has experienced the most rapid growth (see Table 5). According to the CBA, bill payments online have increased over 550% since they started tracking this statistic in 1999. Cash withdrawals through the ABM's levelled out between 2001 and 2002, and dropped in 2003. This was offset by increased usage in Debit Cards, which has the effect of reducing transaction costs for the financial service providers from lower cash handling. These savings are shared with the consumer.

Table 5: Delivery Channel Statistics—Transaction Volumes for the Six Largest Canadian Banks²⁹

Delivery Channels	Number of transactions (in millions)					
	2003	2002	2001	2000	1999	%
ABM	1,131.8	1,206.6	1,209.0	1,239.4	1,156.5	-6.2%
Deposits	258.9	249.2	249.9	244.5	214.9	3.9%
Withdrawals	765.0	848.6	846.2	875.1	838.8	-9.8%
Transfers	43.2	43.7	45.4	48.5	42.4	-1.1%
Bill Payments	64.7	65.1	67.5	71.3	60.3	-0.7%
Debit Cards	1854.7	1,749.6	1,590.6	1,289.8	N/A	6.0%
POS Purchases	1854.7	1,749.6	1,590.6	1,289.8	N/A	6.0%
PC/Internet Banking	192.1	147.0	100.9	47.2	26.6	30.7%
Transfers	57.0	43.3	29.0	10.5	6.4	31.7%
Bill Payments	135.1	103.7	71.9	36.7	20.2	30.3%
Telephone Banking	87.7	92.1	94.6	74.0	63.4	-4.8%
Transfers	18.8	17.3	17.0	16.1	13.7	8.6%
Bill Payments	68.9	74.8	77.6	57.9	49.7	-7.9%

²⁹ Canadian Bankers Association, *Select Delivery Channel Statistics Six Major Banks*, October 2003 www.cba.ca/en/content/stats/040622-delivery%20channels%202003-leaj.pdf accessed June 20, 2004.

3.18 Conclusion

The purpose of this chapter was to analyze the firm's generic strategy, and assess whether the organizational core competencies create strategic fit. Competitive advantages and challenges along the value chain were identified, followed by the evolving culture in the prevailing environment in the organization. Finally, a statistical review provided a perspective on the firm and the industry relative to global competition, and the proliferation of alternate delivery channels.

The next chapter will explore issues in a multiple channel environment, focusing on the opportunities and challenges presented by the online channel, and an integrated delivery strategy.

4 ISSUES

When online banking was first introduced it was anticipated that the branch would be displaced. In fact consumers have taken advantage of the new channel while continuing to use the bricks and mortar channel that they have been accustomed to. A multichannel environment is not a substitute for differentiation, nor is it a *form* of differentiation. Channels are means to an end – in a few years, integrated channels will be a cost of entry. Online banking has limitations when parameters are fuzzy, for example in problem resolution. Its strength is in interactions with set parameters such as online payments, enquiries and other basic functions.

The opportunity presented by the Internet is as a vital part of a customer relationship conducted across multiple channels. Each channel's strength can be leveraged, and channels could be integrated with one another seamlessly.

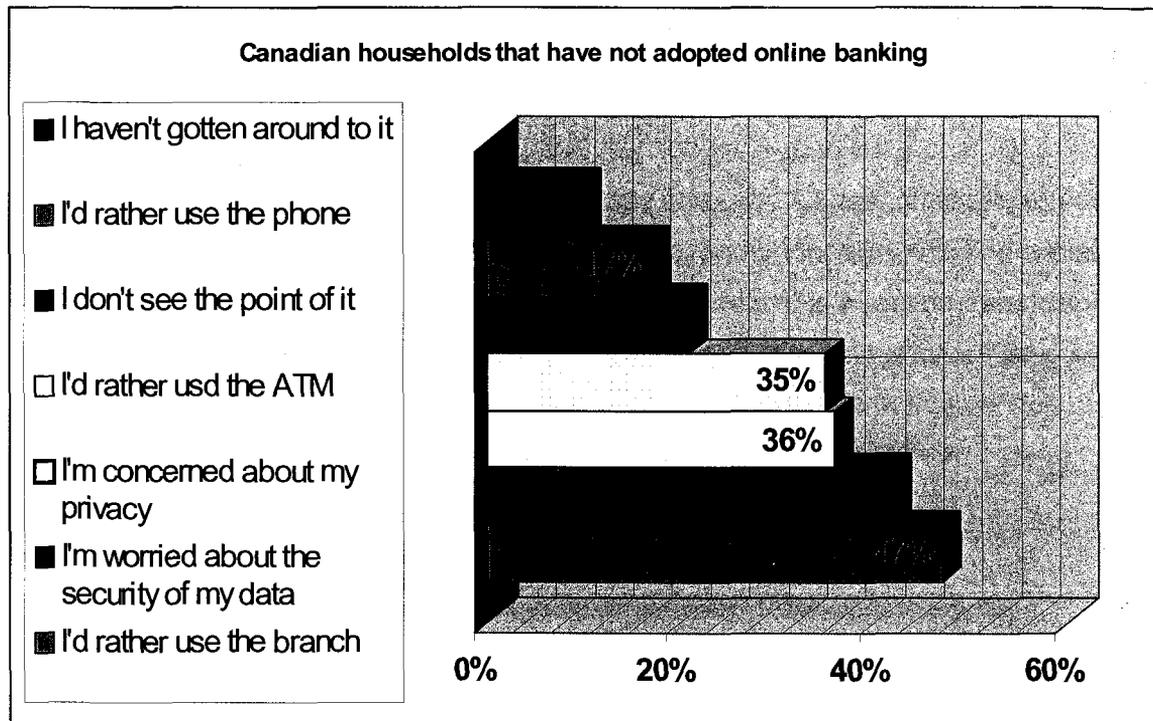
4.1 Online Banking Adoption

The transition to electronic banking in Canada began in the mid 1990s. The banks understood that by right-channelling customers into electronic delivery, service costs would reduce. By enabling a wide range of activities in non-branch channels, the banks would change consumers' banking pattern and reduce reliance on branches. In a cost based strategy, high cost service functions should be moved to lower cost channels. At every opportunity, customers should be moved to online fulfilment from branch fulfilment.

Surveys by Forrester's Research revealed that availability of Internet access through Broadband increases the frequency of online behaviours for routine tasks such as viewing balances. While usage of online banking continues to grow, issues exist in converting non-adopters. As demonstrated in the chart below³⁰ (see Figure 5), the biggest reason why consumers have not started banking online is that they would rather use a branch.

³⁰ Cathy Graeber, *Forrester Research*, survey May 2004.

Figure 5: Reasons for Non-adoption of Online Channel



4.2 Channels Operate Independently

Channels are not designed to interact with each other, with no overall plan for channel coordination. Instead each channel is designed to operate independently, and complete every task from beginning to end. This frustrates customers who use multiple channels. To illustrate, if a customer commences a mortgage application online, and then visits a branch to complete the process, he will have to provide all information again as if it were a new application. Whatever information that he had typed online cannot be retrieved by branch personnel. Conversely, whatever the bank had learned about the customer through the online interaction is lost. Both parties have to repeat steps and revisit choices. Consequently, customers who use multiple channels can take longer to reach their goal than if they stayed with a single channel. As well, until a customer makes a purchase, the bank does not earn revenue. In the above example, the mortgage application is made twice, which is an expense for both channels. If the branch concludes the sale, then it will cover its cost and earn a profit but the online channel will not recover its cost.

4.3 Leveraging Channel Capability

In an effort to provide a full range of capability and convenience to customers, the bank has every channel perform the maximum number of tasks that it can. The chart below demonstrates this (see Table 6). Intuitively, leverage requires a channel to do many things; consequently it is not perfect for any one task. Certain channels will over perform whereas others will be weak at certain tasks and under perform. The online channel for example handles bill payments most efficiently. It is a routine transaction that is linear, following a defined process. All channels are capable of processing bill payments. The most expensive is the branch channel, where human intervention occurs and is therefore subject to errors. Both increase costs to the organization.

Table 6: Functionality at All Channels

Banking Activity	Activities Available at Customer's Choice				
	Branch	ATM	IVR	Call Centre	Online
Balance Inquiry	X	X	X	X	X
Funds Transfer	X	X	X	X	X
Check Deposit	X				
Cash Withdrawal	X				
Account Opening				X	X
Product Search				X	X
Bill Payment	X	X	X	X	X
Cash Deposit	X				
Loan application				X	X

4.4 Product Choice

A myriad of choices are made available to consumers. TD has 64 families of proprietary mutual funds alone; in addition, it sells third party funds. These are distributed through the Call Centre, Online, and Branch channels. Customers can purchase a variety of equities, bonds, and other treasury products. Research information is accessible through TD's Waterhouse website. Similarly, information and choices are available on bank accounts, loans, mortgages, and other products. Left to

their own devices in the direct channels, customers could arrive at inappropriate choices. To illustrate using an example, a client wishes to invest in mutual funds, but is risk averse. He selects a Government Bond capital fund, believing that the principal on Government instruments are protected. He risks capital fluctuation. The bank in turn earns a low spread on this class of funds. This is a losing proposition for both parties to the transaction. Therefore, a customer left to his own devices through the direct channels can result in unintended consequences.

4.5 Customer Uncertainty

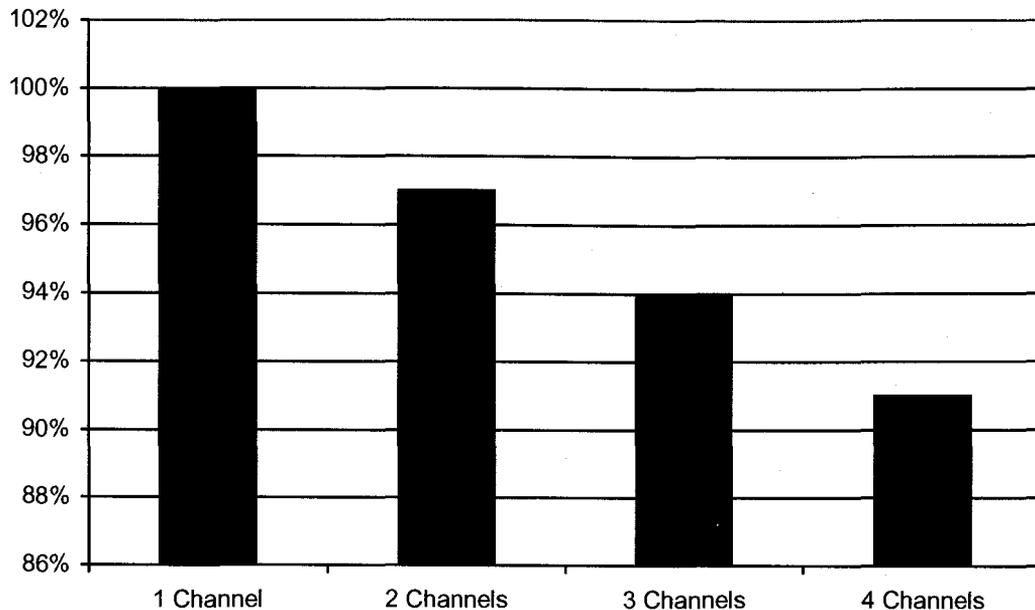
As customers increase usage of different channels, they become less satisfied (see Table 7). The reason is that the bank offers full features on channel options. These channels are not connected however, and neither are they constrained to precisely identify the customer's needs. Analysis by a bank in the U.S. revealed the amount of reduction in customer satisfaction levels as they used more channels³¹ as depicted in the graph below (see Figure 6). Satisfaction rates of customers using four channels were 9% less than those using a single channel. That is significant. When customers use more channels they are required to figure out which channel to use for their need, and to connect that channel to relevant products. Therefore the more channels customers use, the higher the effort required on their part to coordinate the channels and products, and the less satisfied they become.

Table 7: Ranking of Channel by Preference

	Research	Open Account	Obtain Advice	Make Deposit	Trade Securities	Pay for purchases
Online	1	3	3	-	2	4
Branch	3	1	2	1	3	2
Phone	2	2	1	-	1	3
DebitCard	-	-	-	-	-	1

³¹ Council on Financial Competition, *Connected For a Cause*, Page 46, 2003.

Figure 6: Reduction in Customer Satisfaction by Number of Channels Used



4.6 Cost of Relationship Building

There is ongoing tension between relationship building and expense control. In a cost based strategy, a company seeks ways to place a customer in the most efficient delivery vehicle. At TD, branch employees are encouraged to sign a customer to EasyWeb or EasyLine, the two self-serve channels. In addition, through CRM systems, customers are flagged to the Call Centres for proactive sales calls. At the branch, qualified employees who interact with customers are ideal for enhancing customer knowledge and are trained to deliver a comfortable experience. This generates goodwill. But making an investment in providing this experience is a tangible expense that yields intangible benefits.

Similarly, customers are encouraged to contact Call Centres. While employees are encouraged to provide high quality service, they are also measured on an Efficiency Ratio based on length of the call. They are essentially rewarded for shortening the calls, which has the unintended effect of providing little added value to the customer, and hurting the relationship.

4.7 Cost of Service

Tension also exists between cost and providing high quality service. Under a cost based strategy, customers must be “processed” efficiently, but when the competitive environment requires that high quality service also be provided, implementation becomes that much more complicated. This is illustrate by using an example of a service attribute that customers say make a difference to the quality of their experience; being asked ‘if there was anything else we can do for you today’ at the end of the interaction. Assigning costs to this in a single branch yields the following (see Table 8).

Table 8: Projected Cost of 15 Additional Seconds Per Customer to Have a Service Related Exchange³²

Customers serviced by branch tellers each month (125 customers x 7 tellers x 25 days)	21,875
Number of additional hours per month created by 15 seconds exchange	91
Monthly Work Hours per FTE at 75% utilization	118
Number of new FTE required	0.77
Payroll cost per FTE, annualized	\$30,000
Total added cost	\$23,000

This illustrates the cost for a single branch; spread across all branches and call centres across the organization would result in a significant increase in costs. Improving the quality of service can therefore add delivery costs, with no immediate tangible gain.

4.8 Overcoming Biases

Product and channel biases are deeply rooted in every part of an organization. Executives who created these have a vested interest in their success, and are not easily convinced to discard them. In an environment where channels were created independently, many legacy systems exist, which are costly to replace. According to

³² Data based on a branch of TD Canada Trust with \$1 billion book of business.

Mary Grant, Manager, Strategy, e.bank Operations at TD Bank³³, the process to coordinate activities amongst all product groups is slow, due to personal biases of the product groups. In a similar situation cited by Ed Clark, CEO of TD Bank Financial Group³⁴, the bank is in the process of establishing a strategy in the area of lending into Agricultural business. Many regional strategies exist as a coordinated national strategy is not currently in place. The executives have found it difficult to implement a national strategy as the owners of the present strategies are committed to them, and many personalities come into play. This is not ideal for a national organization as it results in inefficiencies across the system, inconsistency in policy, and a message that is not branded.

4.9 Conclusion

This chapter addressed issues that face a firm in integrating multiple distribution channels. The online channel is the most efficient for a bank as marginal costs in that environment are minimal, albeit it is not suited to all of the bank's activities. Increasing usage of this channel was discussed along with the benefits in leveraging all channels by integrating them.

The next chapter will provide recommendations in handling the issues and offer solutions.

³³ Telephone interviews, May and June 2004.

³⁴ Ed Clark, CEO TD Bank Financial Group, presentation to Line Managers, Vancouver, B.C., July 13,2004.

5 RECOMMENDATIONS

This chapter will expand on the issues raised in the preceding section, and offer recommendations to address those issues.

5.1 Increase Adoption of Online Channel

The biggest reason cited by customers for not converting to the online channel is that they prefer to use the branch. To right-channel such customers the bank should use incentives in its transaction pricing. TD Canada Trust uses this approach with their Infinity account, which provides customers unlimited use of alternate channels such as EasyWeb, EasyLine and ATM, but charges a fee of \$1 for every transaction done in the human assisted branch channel.

The second largest concern is that consumers do not feel secure in using the Web for their financial transactions. To counteract concerns about privacy and security of their data, banks should offer no-liability guarantees for its online customers. Wells Fargo in the U.S. for example, offers 100% reimbursement of any funds improperly removed from their accounts. In Canada it is common practice among the banks to reimburse customers for funds that have been subject to fraudulent withdrawal or as a result of identity theft, provided the customer can ascertain that they did not compromise their password. This is not widely known or publicized, but the banks could disclose it to those customers who cite these reasons for not signing up online, in order to convince them to convert.

Many customers are under the impression that it costs more to bank online. Financial institutions in fact offer lower priced services through the online channel. For example, bill payments can be made at no cost online as part of the chequing account package. Banks can overcome this by advertising the free service. As well, branch and Call Centre staff can advise all those customers who pay bills with them that there is a more efficient and less expensive alternative than the person-to-person interaction.

5.2 Increase Channel Interoperability

Channels should be connected so that customers have a seamless experience in switching between channels. This would improve efficiencies as data entry and choice selection would have to occur only once. Connectivity between channels would entail considerable enhancement to technology however. The bank therefore has to make decisions on the amount of investment that it should make, including cost benefit analyses of system upgrades relative to anticipated usage. Partial upgrades could be considered if a certain service is anticipated to be more popular and provide better returns. For example, Voice over Internet Protocol (VOIP) technology is currently available, which would enable the Call Centre and EasyWeb to be connected. If a customer performing a transaction on EasyWeb needs to ask a question, he can access the Call Centre from his terminal. As technology advances, channels will become more connected. Choices will have to be made carefully on where these investments should be made, as there will be ample opportunities to install improved technology.

Another challenge for the bank as it continues to enhance delivery platforms will be to ensure that it divests its legacy systems as these become obsolete. An example that illustrates this issue well is the Check 21 legislation passed in the U.S. in October 2003³⁵. While the number of cheques written in the United States has declined by 2% to 3% each year in the past decade, people still write 40 billion cheques annually. Check 21 will allow banks to provide images with monthly statements rather than sort, file, and return the actual cheques. This is estimated to save 25% or \$2 Billion, in processing costs. New challenges will accompany this change. Electronic migration will alter the dynamics in the payments clearing system by making the current value drivers in cheques increasingly irrelevant. These drivers are geographic proximity, efficient manual labour, and maximizing clearing balances. As well, the unit cost of processing paper cheques will escalate as the shift to electronic processing progresses, leaving behind large infrastructure costs. In the long term these legacy infrastructure systems will become obsolete.

³⁵ Kevin P. Coyne, Lenny T. Mendonca, Gregory Wilson, Can banks grow beyond mergers and acquisitions, *The McKinsey Quarterly*, 2004 Number 1, pp. 76-77.

Until technology enhancements make interoperability possible, manual intervention could provide a solution. Recently TD piloted two programs to test this: when customers open core banking accounts through EasyLine or EasyWeb, a “single registration” process is followed. Their account documentation is forwarded to the three channels that open accounts, including the branch, which ensures that the client will receive a comfortable experience at all channels. This requires a lengthy manual process, which would ideally be served by enabling systems to record images of the documentation online rather than transfer physical documents. The second program is for customers that are new to the bank. When they open accounts with non-branch channels welcome letters are sent, containing information of the branch closest to them, and inviting contact to set up a savings program. The purpose is to deepen the relationship by taking advantage of the extensive branch network and to increase share of wallet by cross selling more products. This does leave the customer in control of the process, as they would act on the letter only if they desire, rather than the bank driving the process and retaining control of the relationship.

Both of these programs require manual intervention, which are not efficient and not suited to a cost based strategy. Costs increase, and the desired outcome of improving operational efficiencies while at the same time increase customers' share of wallet are not certain to be achieved.

The bank would be well served to focus on interoperability of the channels through technology improvements.

5.3 Leverage Channels

To maximize the benefits of a multi channel environment, consumers should be given a choice to bank through the channel that they find most convenient. To compensate for this choice and even entice customers to choose the channel that is most efficient for the bank, services should be priced to match transaction costs. Bill payments for instance are handled most efficiently online. A premium should be charged if they are paid through the branch, which requires human intervention and is therefore more expensive to process.

Customers should be right channelled through account pricing structures. Bundling services into price-based packages is a good strategy, with lowest fees applicable to the most efficient channel and premiums charged where customers prefer to perform transactions through channels that are less efficient for the bank. The process of right channelling customers should be handled with care, and due attention paid to how this might be perceived by customers. A heavy-handed approach might cause an adverse reaction, resulting in a loss of clients. TD experienced this in the late 1990s when it reduced hours of teller service, and shepherded clients to ATM's. The reaction from customers was swift, and the bank had to revert to prior levels of service.

5.4 Simplify Product Choice

With human interaction at the branches or call centres, a qualified representative will probe for the underlying purpose so that the customer makes rational choices. Technology is not sufficiently sophisticated yet to elicit intelligent selections. Customers self-select products after conducting their own research. While some tools are available on the web sites, these are guides only and do not return specific solutions.

Sophisticated technology can be acquired; however this would require substantial investment. While transaction costs would reduce, once the cost of the investment and the payback period are factored in, the return would likely not be attractive.

For the mass distribution channels, which focus on a low cost strategy, simple solutions should be introduced across the range of products and services. The number of mutual funds should be consolidated into the few that are suitable to the majority of clients; account choices should be reduced, and options on loans and mortgages should be limited so that the cost to deliver these is lower, and the customer can make choices more quickly and with confidence. Those 10% of the customers that require more sophisticated services should be up-tiered to Private Client Centres where more qualified personnel can provide services for appropriate fees.

A good example of this is the Honda Accord strategy³⁶, which built a value proposition. Honda understood a need, defined a solution, and tailored the configuration. In 1980, the options offered by General Motor's Buick could be combined in numerous different ways. Manufacturing became very complex as every Buick could be built to order. Distribution became complex because these cars had to be delivered to specific individuals. Honda in contrast, offered three versions of the Accord. Each had two option packages; so six combinations were available in all. These combinations were suitable for the 25% of the market that was the most profitable segment. Honda dominated this segment for nine years.

Simplifying the product and services availability in this manner will result in solutions that are easier for the customer, therefore less prone to error and misjudgement. This will result in a more satisfying experience in the long term therefore customer retention will improve. For the bank, the cost to deliver these simplified solutions will reduce substantially, as they will not try to be all things to all people, and will offer the right choices that are suited to the majority of their clients. The bank will have to be brave in adopting this approach as competitor banks will continue to provide a variety of products as they presently do, and the fear would be that some customers might be lost to the competition. There may be adverse ramifications in the short term as customers who are accustomed to being offered a wide range of options will not receive these. That may be perceived as a reduction in service, but over time this will be less of an issue as packages that are most widely suited will be the ones offered. Returns from this strategy may not be immediate, but will pay off with some patience.

5.5 Reduce Customer Uncertainty

Over the past decade, when more channels became available, particularly with the proliferation of technological advancements in the Internet and in telephony, banks began to build capabilities in direct banking for consumers to bank online, and through Call Centres. All banks were caught up in the race to put the most capability they could in the hands of the customer. The channels were built in silos, with no coordination and connectivity to existing channels. Similarly, Call Centre capabilities were enhanced

³⁶ Council on Financial Competition, *Connected For a Cause*, p. 32, 2003.

considerably, and the banks established centres across the country. In the case of TD bank, they built centres in Vancouver, Edmonton, and Toronto. They soon realized these centres were performing overlapping functions, and have since consolidated into a single Call Centre located in London, Ontario.

Mary Grant of TD's e.bank advises that business units have until now established their own strategies which were then rolled up into the delivery channels. The bank is now embarking on a global strategy, whereby it takes an enterprise wide view of how to best serve customers, maximize operational efficiencies, and earn the most rents. Interestingly, TD's e.bank's vision is to "provide a superior customer and employee experience in partnership with all TD business groups, through the efficient operation and strategic growth of electronic channels". Five goals have been established for fiscal years 2004 and 2005:

- Enhance customer experience
- Achieve operational excellence in all e.businesses
- Focus on growing sales and transaction activity which add economic value to the bank
- Make e.bank a great place to work
- Cross channel integration

The bank has recognized some key activities in which to develop core competencies. If they excel at these, then they will gain sustainable competitive advantages. By integrating with other channels, the customer experience will be enhanced, retention will improve, and operating costs will decline through lower duplication. Achieving operational excellence is an evolving objective. It should always be a goal of any organization whose business is heavily process oriented, and which follows a cost based strategy. And by focusing on growing activity that adds economic value to the bank, e.bank will be leveraging improvements across the organization. It will encourage use of the direct channels where there are cost advantages to the bank and concurrently can be processed with the least effort by the customer. This will drive down costs.

By understanding the strategies of the business partners and rolling these up, businesses and channels will become better integrated. Activities will be coordinated, common needs developed, and capacity then built by IT to enable implementation.

In this manner, channel fit will improve, and the bank will better retain control of the customer. In trying to be all things to all people, the customer's anxiety actually increases as he tries to force the channel to fit the product. Lack of connectivity between the channels puts the responsibility of choice on the customer, placing the bank at risk of providing the customer with a poor experience. If the branch channel better handles a product, then it should not be offered through the Call Centre or the web.

The goal to make e.bank a great place to work is in recognition of the nature of the functions that employees are required to perform. They are mostly routine tasks. Similarly at most levels of the organization, with decision making centralized, keeping talented staff motivated can be challenging. To counteract this, employees should be rotated through a variety of jobs in all channels. Otherwise the bank may not be able to retain high calibre employees.

5.6 Build Relationships

Building good relationships cost money. While it is important to move customer transactions to the most effective channel, employee performance measurement should include rewards for relationship building. For example, at the Call Centres, rather than build an efficiency model based on number of calls handled, metrics should be developed for up-sell ratios. Employees should be rewarded for handling calls efficiently as well as for converting enquiries into closed sales.

By shifting customers to direct channels, banks lose the opportunity to deepen relationships and increase cross sales that can be done when customers visit the branches and interact with employees. Therefore the online site should be state of the art. It should contain complete content, possess good functionality, be easy to manoeuvre, and have all tools and applications that a customer may need. As well, the site should be appealing so that visitors would stay longer once they complete the transaction, and learn more about the bank's complete range of services.

5.7 Cost of Quality Service

Being that the strategy is cost based but requires high quality service, the bank must implement service quality standards. Banks have invested heavily in efforts to keep customers satisfied, and want to build strong relationships. A study by McKinsey & Company³⁷ suggests three factors are particularly important to bank clients: the first is ease of use. Until recently a bank could stand out for having several points of access – ATM's, branches, and web sites. Consumers now take these amenities for granted, and are interested in what transpires at the point of access. They prefer quick and pleasant service, and obtain exactly the products and services they want.

Secondly, consumers want accurate opening and fulfilment of accounts. These activities give rise to errors. The third most important factor is the bank's ability to correct these errors. Customers are willing to forgive mistakes if banks fix them quickly and transparently. According to Brad Francis, Manager Marketing Research and Customer Care at TD Bank³⁸, the bank undertakes considerable research through a third party vendor to determine the highest impact areas on customer satisfaction. As an example, customers will state that service fees are important to them in selecting a bank. In researching the actual impact of this attribute it is found to be of low impact. TD's research reveals that attributes such as "Makes You Feel Comfortable", Quick and Flexible Banking", and "Convenient Banking Locations" are in the quadrant that contains stated importance as well as actual importance to the customer. The bank therefore has invested in developing long-term strategies around these. Credible commitment or "proof points" are required to signal the banks intent to its customers. TD Canada Trust therefore has extended hours (8 to 8). This is a meaningful and relevant difference from competitors' hours of operation. TD establishes branches in locations that are convenient to access, and are not destination points, and finally they maintain strict control over the design of the branches and all of their access points so that the message and the image are consistent. Branding remains at the forefront at all times; the TD brand has become familiar to consumers, which in turn builds a sense of

³⁷ Kevin P. Coyne, Lenny T. Mendonca, Gregory Wilson, Reinventing the customer experience, *The McKinsey Quarterly*, 2004 Number 1, pp. 74.

³⁸ Telephone interviews, June 2004.

security, trust in the bank and an overall feeling of comfort with the organization.

The bank should leverage contact points to increase its share of wallet. It must invest in the customer rather than risk losing him, so that it can retain the potential opportunity to gain a tangible benefit when the customer needs to acquire a service or product. CRM systems should be designed to promote services at the ATM's and other delivery points. TD currently has a system that prompts a teller to offer a service that the customer currently does not have, and is a suitable candidate for. Similar CRM systems are in place at Call Centres, to make proactive calls and react to system generated prompts when interacting with a client.

The system also identifies which customers should be referred to up-tier business partners in the wealth management areas of the bank. Intelligent CRM systems are required to meet the customers' preference for receiving exactly the products and services they want. This will also result in the bank retaining control of the choices the customer makes, leading to a better customer experience rather than have the customer become frustrated by forcing them to make their own choices.

5.8 Overcome Bias by Becoming Customer Centric

The bank can overcome internal biases by making the customer the focus of the whole enterprise. Such an undertaking would require revamping many current practices, and the thought processes of the executive, bearing in mind the personalities involved.

A comprehensive program to bring every product and channel to an equal footing and making the enterprise indifferent to considerations other than customer need would have to be undertaken. An integrated view of the customer should be developed, to give the bank a truly customer centric perspective. The integrated view would list all the products that the client has with the bank, what channels he uses, and the profitability of the customer: revenue the bank generates from him and the cost of servicing him.

This would involve merging all systems onto one platform. Next, solution based packages should be offered to customers, rather than product based. For example, a Home Purchase package could include a Mortgage, Disability insurance, and Mortgage

Life Insurance. As clients move through their stages in the life cycle, they would require different solutions. Arrival of children would require a package consisting of Youth Accounts, Registered Education Savings Plan, and increased life insurance protection. Similar to the successful practice followed in the fast food industry, each package would be bundled, with attractive value based pricing. If a customer preferred an individual component, this would be made available at a premium over the bundled price.

Segmentation by age groups would be the next logical step. The needs of older affluent clients are different than those of young professionals. Customer needs are predictable through life cycle changes therefore can be met by designing suitable bundles. A bundle for an older client may consist of core savings and chequing accounts, service through the branch channel, mutual funds, life insurance, retirement income annuity, and advice on estate planning. By contrast, for a young professional, a bundle would consist of core savings and chequing accounts, mortgage, credit card, direct banking such as EasyWeb and EasyLine, self directed discount trading, monthly savings plans, and advice on how to shelter income from taxes.

A study by a European bank³⁹ revealed that customers who purchased a bundle of products and services use the products 3.2 times, compared to 1.4 times for those who acquired individual products. The profit to the bank after allowing for value discounts for packages was 40 % higher; and customer retention was four times longer. TD Canada Trust offers a value bundle that includes core-banking needs such as bank accounts, credit card, and usage of distribution channels, but it does not extend to life stage needs. The banks own data indicates that customers with four or more services are three times less likely to switch banks. It is common practice among Canadians to have multiple banking relationships. Consumers may have core banking at one financial institution, their retirement plans with another bank, and mortgage at yet another. The bank is also able to better retain those customers that have a Direct Deposit arrangement, where their pay is deposited into their bank account electronically, and have more success at expanding the relationship with cross sales.

The next stage would be to train employees on Solution based packages, so

³⁹ Corporate Executive Board, *Renewing Responsibility for the Retail Bank Value Proposition*, 2003.

they recognize when a customer is moving into another life cycle stage, and proactively offer a suitable package that is needs based. Presently, employees are trained on specific products, and customers are placed in specific products and channels. Finally, the compensation system would need to be revised. The present arrangement at TD Canada Trust retail distribution channels includes a combination of base pay plus a variable component based on performance of the bank, the branch, and individual. On average up to 20% of the pay is performance based. Some product sales generate more revenue for employees, for example Insurance sales attach a large premium upon sign up, given that the product is lucrative for the bank. In keeping with the expected bias towards commissions, employees sell more Insurance products in order to achieve their revenue targets, and overlook the customer need. A revised system should be product neutral. Performance measurement should be based on multi-product sales. The variable compensation portion should be lowered, and awarded based on multiple product thresholds. Commission structure drives employee behaviour. In order to meet multi-product goals, they would have to sell multi-product packages, which should be designed for specific customer needs. Effectively therefore, employees will earn their commissions based on the number of needs they meet, ensuring focus remains on the customer.

5.9 Needs Based Bundling

Presently the bank offers many permutations of products and services. For example, there are 64 proprietary TD mutual funds alone. Several of these may be sold to a single customer, and these can be combined with several other equity and bond instruments to design an investment portfolio for a client. In addition, the client may have any combination of core bank accounts, charge cards, credit protection life insurance, loan disability insurance, and lines of credit to name a few. By bundling a series of products around specific needs, many independent and overlapping products would be made redundant. This will benefit:

5.9.1 Sales Staff

It is well established that the 80/20 rule also applies to selling products. The staff becomes comfortable in selling certain products, and with repetitive sales become very proficient at explaining the features and benefits of these products. Thus successful

salespeople sell these 20% of the products 80% of the time. Instead of trying to master a myriad of products with varying levels of complexity, under the Needs Based model staff would look for distinct life-cycle needs. They would then sell the right package off the shelf to meet this need. The burden would shift from the staff to the process and the product.

5.9.2 Customers

Customers would be asked to make selections from simplified menus rather than on a combination of products from a series with varying levels of sophistication and complexity. As demonstrated earlier, with more choice placed in the hands of the customer, they actually become less satisfied, and product usage declines. Needs Based bundling simplifies the connections between the products and channels, and becomes a comfortable path of least resistance for the customer.

5.9.3 Back Office Operations

The bank operates in a high volume environment. Consequently they have developed core competencies around processing mass volumes and work flows. The increase in the variety of products and distribution channels creates pressures on back office functions. A series of unique requirements to be processed on a system designed for processing high volumes of routine transactions creates operational inefficiencies, and reduces speed due to exception processing.

5.9.4 Profitability

Labour would become more efficient. Rather than having to master a large number of products, sales employees would be required to master a few Needs Based bundles. They would become more proficient and gain confidence in the products, which would increase sales. With repetitive sales they would deliver products quicker, reducing efficiency ratios.

With decision-making removed from the customer, bundles could include products that are profitable to the bank. These would be sold at discounts in a bundle; therefore the consumer would still find the cost sufficiently attractive. By connecting

specific costs to revenues, the bundles would ensure costs are covered and a margin earned.

Cost savings would result in back office operations from enhanced efficiencies. With fewer items to be processed as exceptions, the staff would become more efficient, and down time would be reduced. There would be a positive impact on morale, which would increase productivity.

Overall therefore the bank's profitability would increase from Needs Based offerings.

5.10 Conclusion

This chapter offered recommendations on handling issues arising in a multi channel environment. Identifying and acknowledging that certain channels are more suited to specific transactions, integrating channels offers the optimum solution. Furthermore, a Needs Based solution was proposed to revamp all existing systems into a more efficient and simplified platform. Product offerings would be simplified, improving the quality of choices and the customer's experience in making the selection. This solution is well suited to a cost based/high quality strategy.

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