Visualizing strategies for financial services

Maria Gonzalez and Henry Mintzberg

THE PAST DECADE has witnessed unprecedented change in the selling of financial services. An enormous amount of convention and regulation has given way before new patterns of financing, advances in information technology, fierce domestic and international competition, and the increasing integration of international financial markets. Not surprisingly, this change has created much confusion. Our intention in this article is to help managers see their way through that confusion. What we propose is a simple, visual depiction of the industry – as it was and as it is becoming.

Traditional strategies

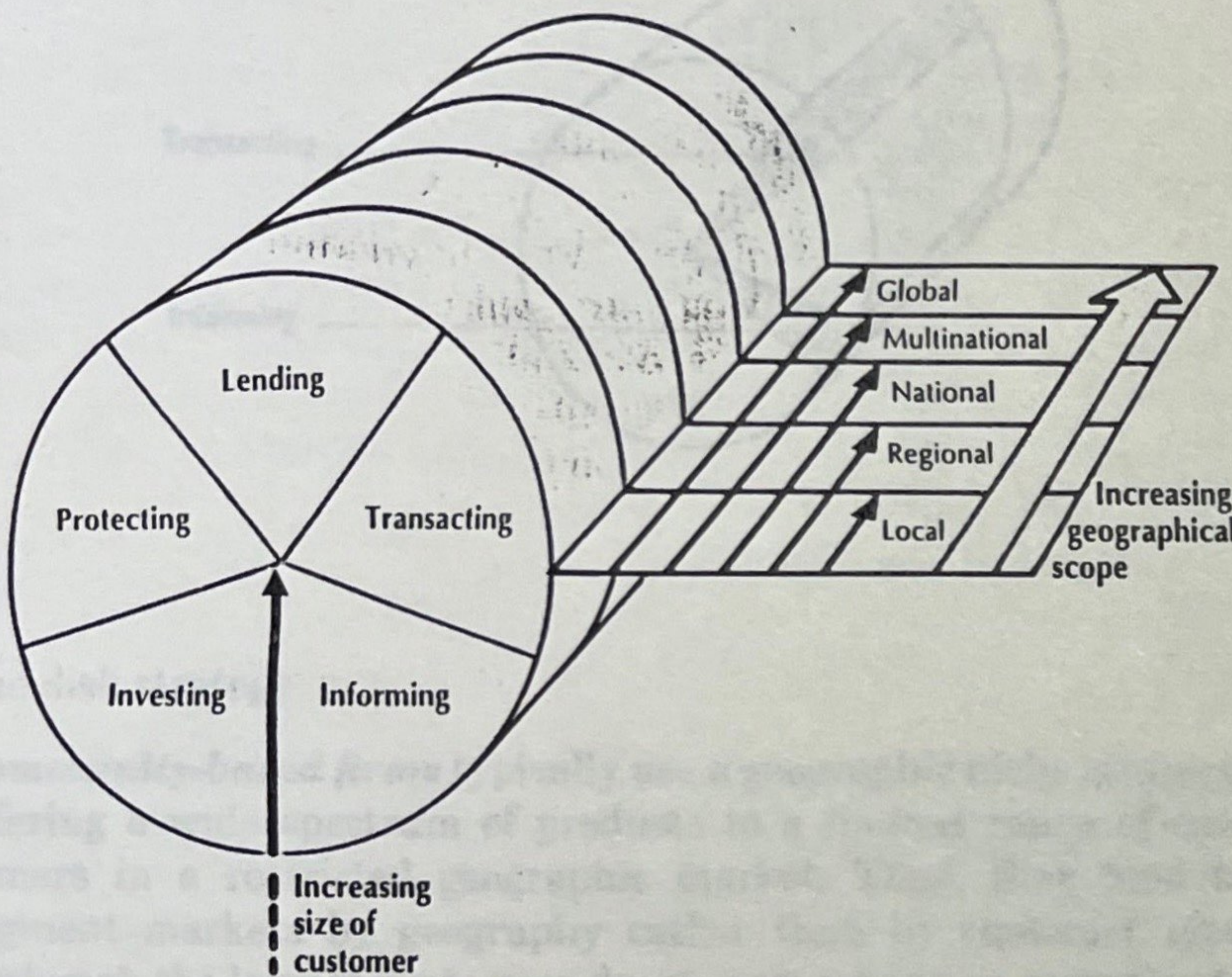
Conventional industry structure exhibited clear accountabilities and responsibilities within particular segments. Each was limited as to the products sold, who could sell them, and the kinds of companies that could own and be owned by financial institutions. Commercial lending was, for example, clearly distinguished from investment banking. In Canada, banks could not own securities firms before 1986; in the United States, although deregulation is under way, true nationwide banking is still not yet in place.

The financial services cylinder

The overall industry can be depicted as a cylinder, as shown in Exhibit I. The cylinder's cross section or perimeter circle can be divided into basic services: ***investing***, as in mutual funds and savings accounts; ***lending***, as in mortgages, bonds, and commercial loans; ***protecting***, as in insurance, reinsurance, and safety deposit boxes; ***transacting***, as in checking, stock brokerage, and underwriting; and ***informing***, as in tax planning and advising on mergers and acquisitions.

The radius of the circle represents ***customer size*** – ranging from the smallest retail consumers at the outer edge, through the wealthy retail and smaller wholesale customers near the middle,

Exhibit I Dimensions of financial services



to the major corporate customers with the largest volume of transactions in the center.

Finally, the cylinder's lateral dimension shows the ***geographical scope*** of relevant markets – from local to regional, national, multinational, and global.

Wedge strategies

With this figure in mind, we can describe the traditional posture of the financial services industry in terms of ***wedge strategies***. Groups of producers provided unique bundles of services along the entire radius of the circle. In other words, they paid relatively little attention to market segmentation. A bank, for example, would offer identical checking accounts to retail customers large and small, with the charges independent of the size or number of transactions. Geographical scope also tended to be defined by producer rather than by product. A bank might operate locally, providing all of its services to the same set of municipal customers.

In this way, individual players took their wedge-like positions in well-defined sectors of the industry. Indeed, the word "industry" is really misleading here, for each of the sectors was really an industry unto itself. In the United States, the major sectors – banking/trust, savings and loans, insurance, and brokerage – were to a great extent separate entities, each with its own customers and specific focus, much of it local or regional in scope.

Note that we are not equating particular sectors with the particular services shown on our circle. Banks operated largely in the lending and transacting areas, but they also provided protection services such as safety deposit boxes, even though the most lucrative protection market – insurance – was closed to them. Thus, for some players at least, the wedges were not single but multiple. The traditional strategy of a local US bank is shown in Exhibit II; that of a national brokerage house in Exhibit III.

New strategies

The many changes that have buffeted the financial services industry in recent years have, in effect, blown apart many of the strategic wedges, which often represented largely undifferentiated and unsegmented bundles of services protected by regulatory barriers. The resulting debris has settled down in a variety of new patterns, according to how firms have selected and combined their services, customers, and markets. Visually, on our cylinder, wedges have been replaced by all kinds of strange and wonderful shapes, which we call strategies. We find six such strategies common today.

Exhibit II Traditional local US banking strategy

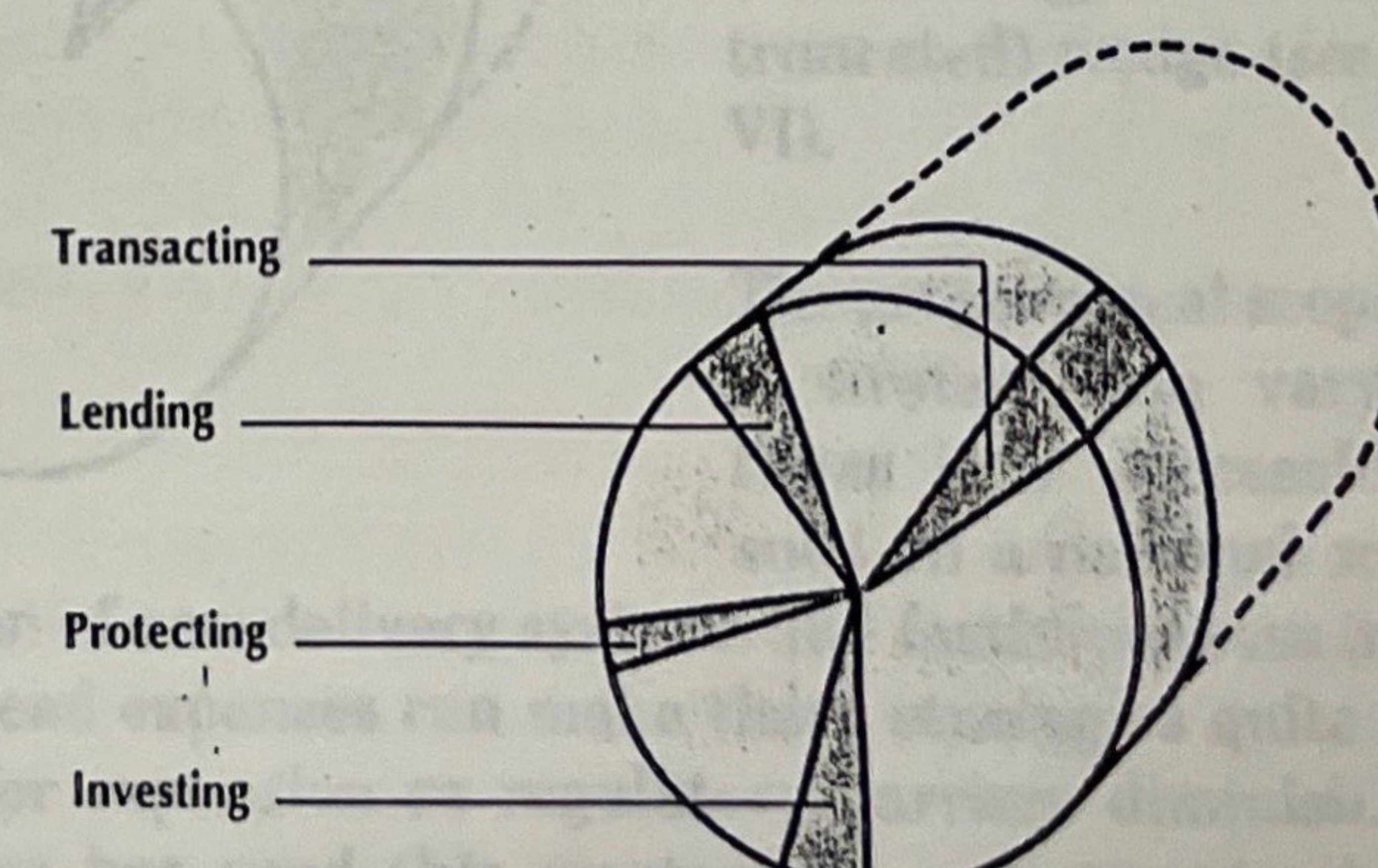
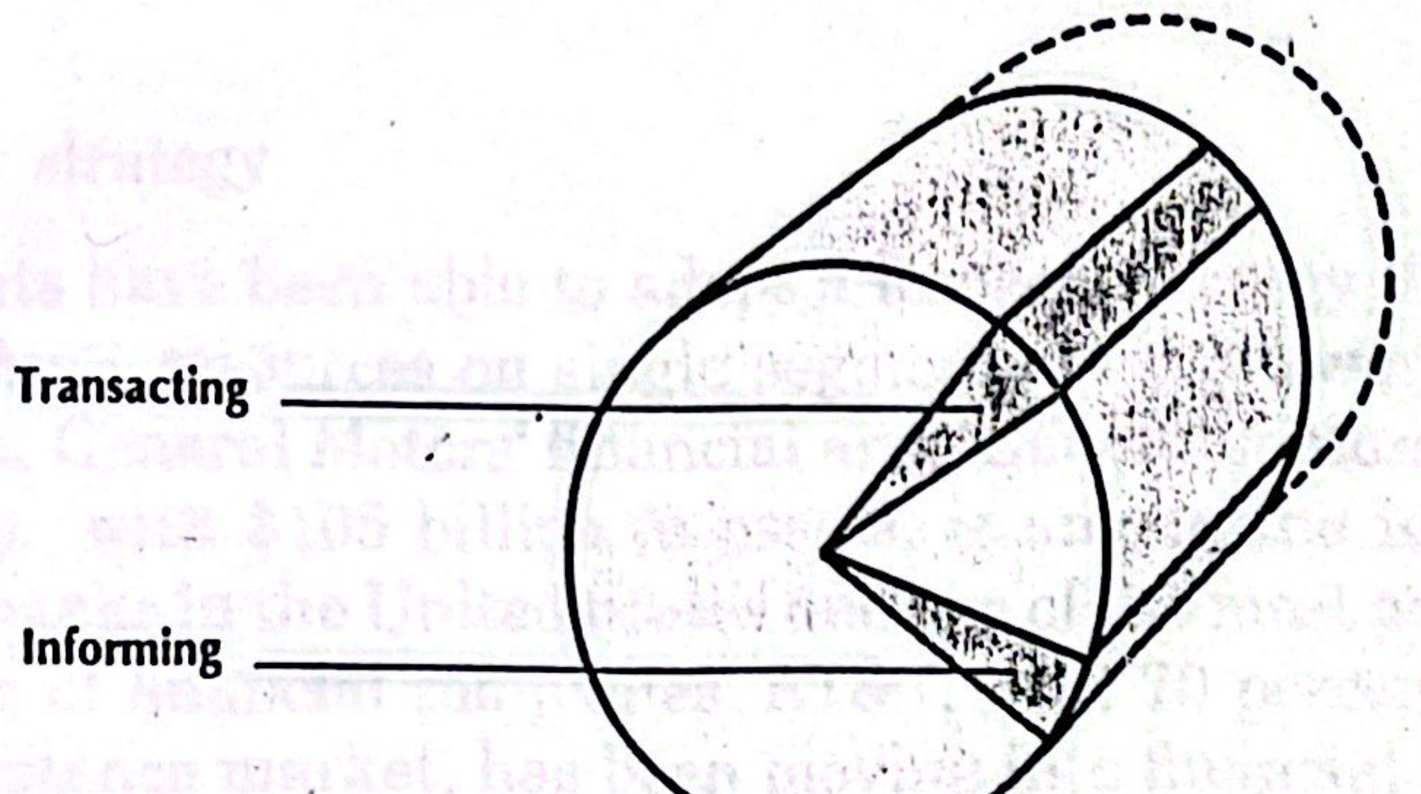


Exhibit III Traditional national brokerage house strategy

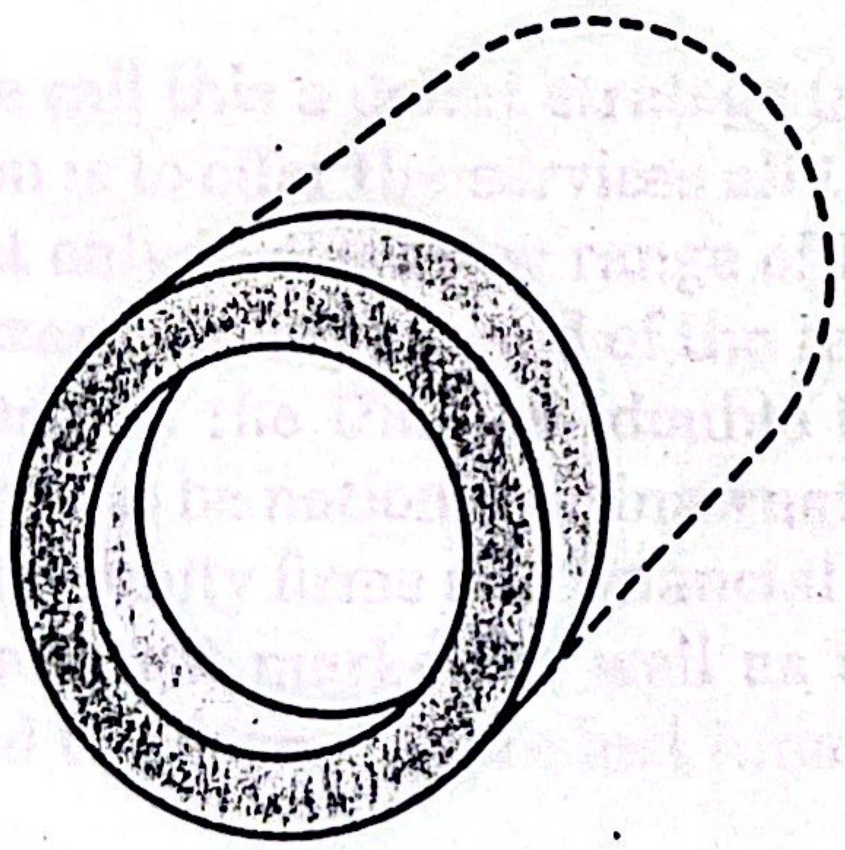


The disk strategy

Community-based firms typically use a geographic niche strategy, offering a wide spectrum of products to a limited range of customers in a restricted geographic market. Thus, they tend to segment markets by geography rather than by customer type (although the largest customers do, of course, have an incentive to shop away from home). Accordingly, we show this strategy as a wide but thin disk (*see* Exhibit IV).

Firms following a disk strategy are sometimes unchallenged by larger ones because of the costs of providing services to their geographic niches and because of strong customer loyalty based on personalized service. Credit unions tend to use this strategy – the Desjardins Group of Quebec, for example, a major competitor to Canada's largest banks. It comprises 1,339 such unions in Quebec alone, rivalling the total for the largest bank in Canada, the Royal, which has 1,636 branches across the country.

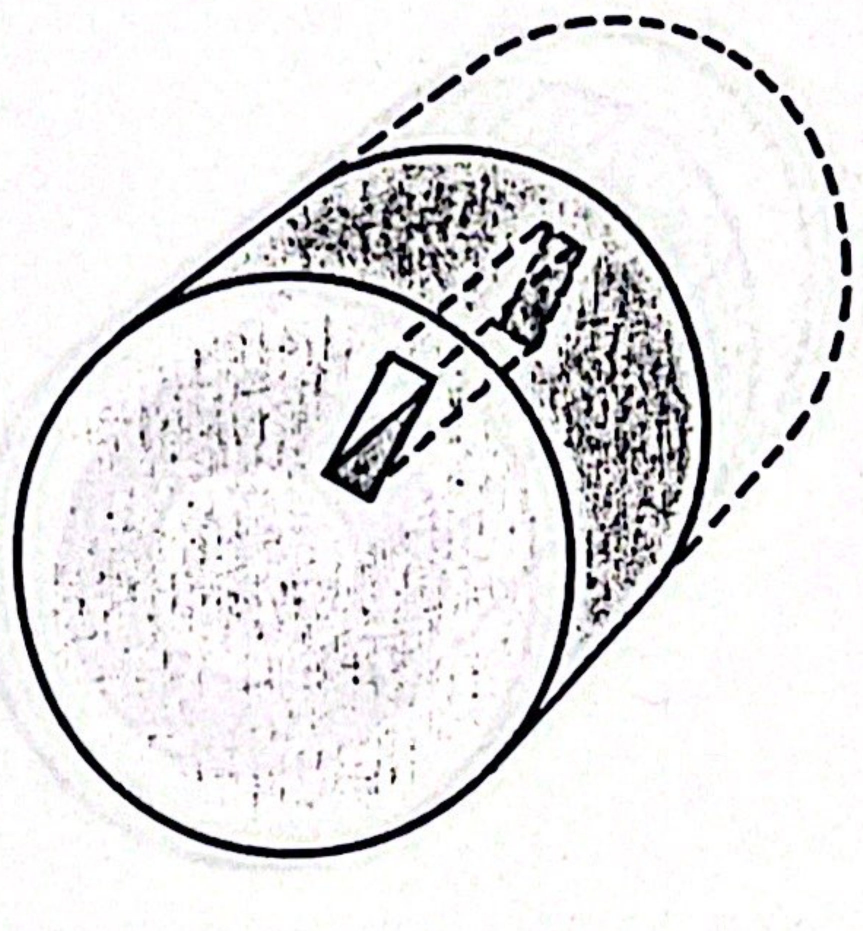
Exhibit IV The disc strategy



The rifle shot strategy

Financial organizations that provide focused products or services are known as specialty firms or ***boutiques***. They target their offerings to specific customer groups, using specialized expertise to develop their niches. We show this strategy, essentially one of product differentiation, as a rifle shot, restricted to one part of one segment – and to a fairly narrow range of customers within that (*see* Exhibit V). This strategy may or may not be focused geographically.

Exhibit V The rifle shot strategy

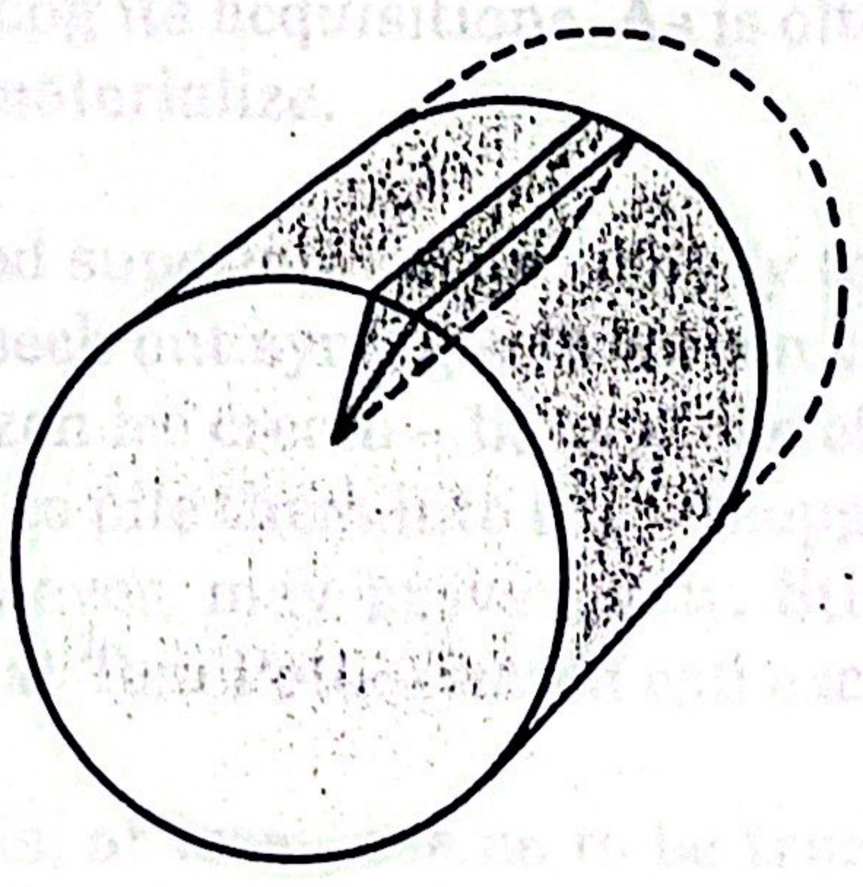


For a time before its demise, Drexel, the US junk bond powerhouse, veered away from and then tried to get back to its focus on medium-sized wholesale customers. Wasserstein Perella & Company, one of the most successful of the small firms specializing in merger advice, also uses the rifle shot strategy.

The thin wedge strategy

A strategy often adopted by firms seeking entrance to a new market is that of being a ***price leader***. These firms generally provide a narrow range of unbundled services and concentrate on their delivery at the lowest possible cost. Whereas boutiques differentiate their products, price leaders differentiate their cost to the customer. This, of course, tends to attract customers at the lower end of the scale. That is why we show this strategy as a thin (and truncated) wedge (*see* Exhibit VI).

Exhibit VI The thin wedge strategy

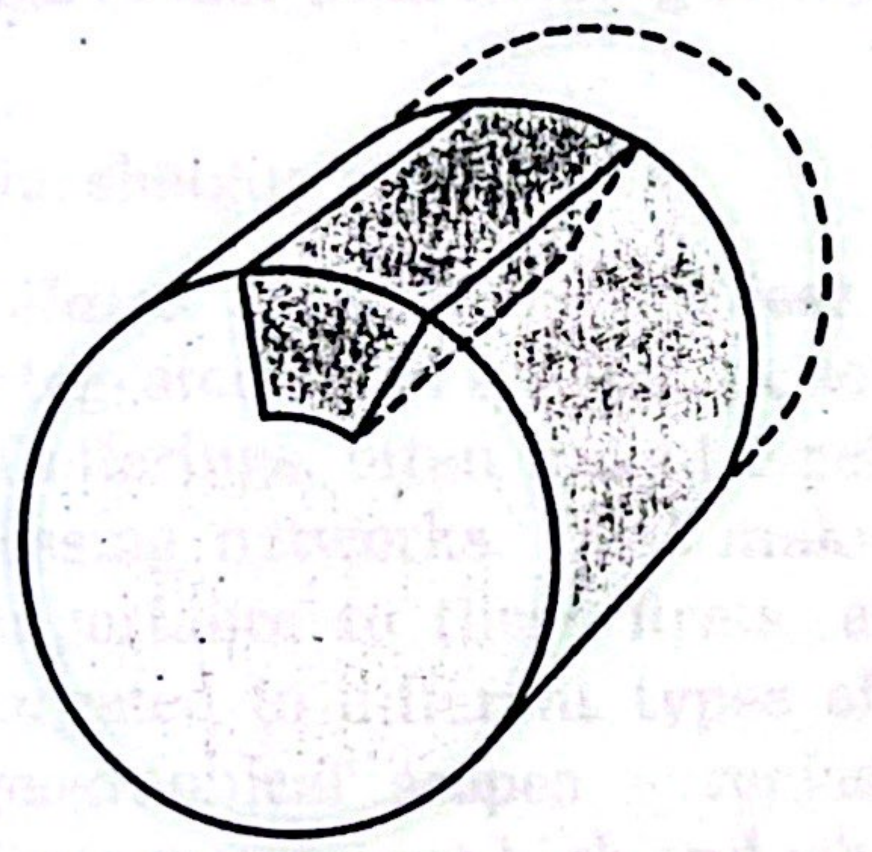


The geographical scope of such a strategy can vary. Sometimes it is successfully pursued on a national scale. Full exploitation of new delivery systems and fastidiousness in controlling overhead expenses can make these strategies quite effective, allowing for expansion as regulatory barriers diminish. Dreyfus Corporation has used this strategy as investment adviser and manager of mutual funds. By running a mail and telephone operation, it is less susceptible to adding overhead than many of its competitors.

The chunk strategy

A few giants have been able to adopt a focused strategy that concentrates huge resources on single segments in the lower part of the market. General Motors' financial arm, General Motors Acceptance Corp., with $105 billion in assets, is among the top three mortgage banks in the United States and one of the most profitable of all types of financial companies. AT&T, with 70 percent of the US long-distance market, has been moving into financial services since 1984. In March 1990 it launched a combination calling and credit card. Within 10 months, it became the sixth most popular bank credit card in the United States.

Exhibit VII The chunk strategy



We depict the strategy of these ***dominant players*** as one big chunk – in effect, a thick truncated wedge (*see* Exhibit VII).

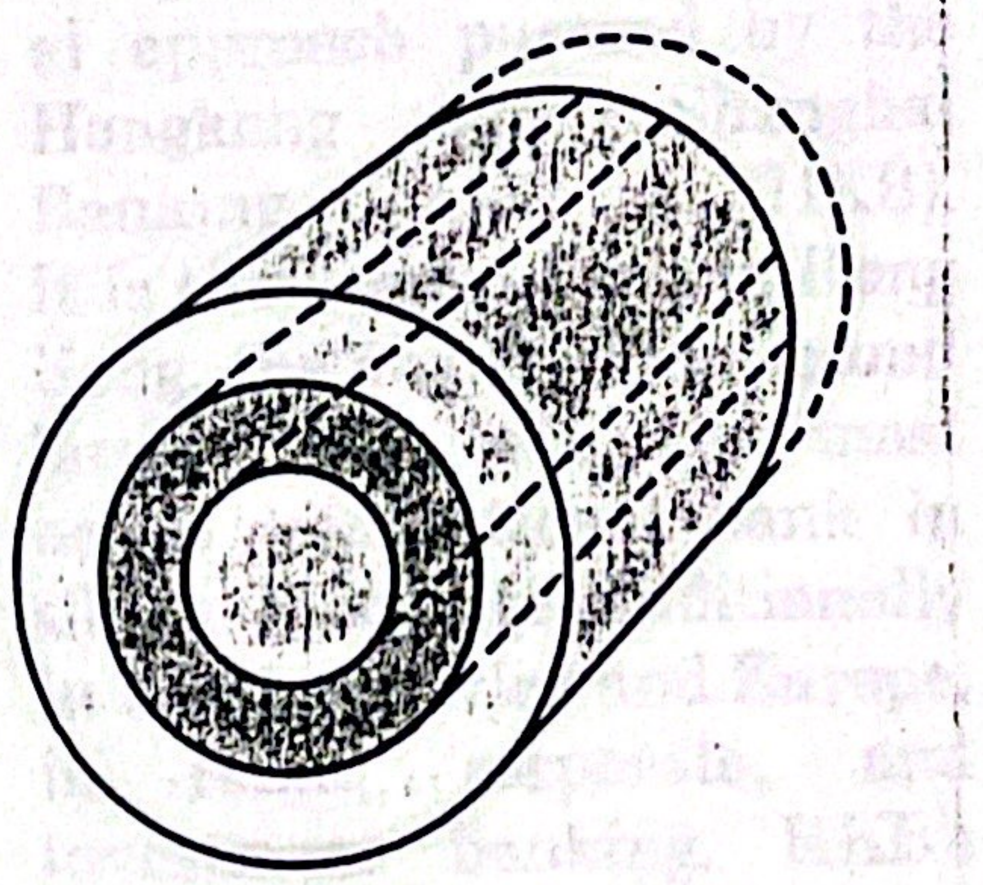
The donut strategy

One strategy that has received a great deal of attention for some years now is that of the composite rebundler or simply the ***financial supermarket*** – the ultimate in one-stop financial shopping. The intention here is to provide the widest range of services to a well-defined customer segment in the hope of creating synergies among the various offerings. Previously unbundled services are often bundled in innovative ways.

We call this a donut strategy (*see* Exhibit VIII) because the intention is to offer the services all the way around the face of our circle but only in a narrow range of its radius, often near the middle or toward the higher end of the retail market – for example, the Yuppies and the Dinkies (double income, no kids). Geographic scope tends to be national or international. Thus, the difference between community firms and financial supermarkets is often the wealth of the target market as well as the breadth of geographic coverage and the degree of product innovation.

Merrill Lynch is a prime example of a financial supermarket. It explicitly focuses on "being all things to some people" and offers the gamut of retail financial services – securities, savings instruments, insurance, realty products, and counselling – to relatively affluent investors. Its competitive presence is felt in both domestic and foreign markets. Its strategy of cross-selling its products and services requires a large and expensive infrastructure, which puts it at a disadvantage in competing with price leaders such as Dreyfus. Indeed, its problem is much like that of the traditional food supermarkets whose markets have been eroded by discount warehouse stores on one side and specialty groceries on the other.

Exhibit VIII The donut strategy



Sears is another well-known financial supermarket, although at the lower end of the market. It first sold financial services to its own charge card customers. By 1986 it had evolved into a financial services network with the stated objective of becoming the "one-stop financial provider to Main Street America." At present, its strategy is to refocus its financial services business on consumer services such as insurance, real estate, retail brokerage, investment banking, card services, and consumer lending. Early on, Sears created a "Synergy Committee" to capitalize on the links among its acquisitions. As is often the case, synergy has been slow to materialize.

Food supermarkets naturally tend to be efficient: there is no need to seek out synergies between cans of frozen peas and packages of frozen ice cream – beyond the obvious one of getting the same people to pile them into their shopping carts. Financial supermarkets, however, may prove costly. Still, if executed with creativity and what Tom Peters would call excellence, they may prove viable.

This, at least, seems to be true for American Express, which has parlayed its charge card and traveller's check businesses into its current position as a major worldwide provider of a host of financial services – including private banking, investment management, investment banking, retail banking, life insurance, mutual funds, travel services, and information services in addition, of course, to charge cards and traveller's checks. The company's strategy is to think globally while marketing locally, delivering its wide variety of services to carefully-targeted segments of the worldwide market.

Nomura Securities Co. Ltd also pursues a donut strategy. In 1988, it ranked first in net income before taxes among all international financial institutions, and by mid-1989 had achieved the largest market capitalization of any such institution in the world. Nomura provides the widest range of investment-related services in Japan and abroad. Its research capabilities, among the best in the world, have been carefully integrated with its information management capabilities. It exploits synergies through a globally-integrated network. Nomura differs, however, from other financial supermarkets in its use of alliances with top-tier boutiques in local markets rather than making straight acquisitions or building *de novo*.

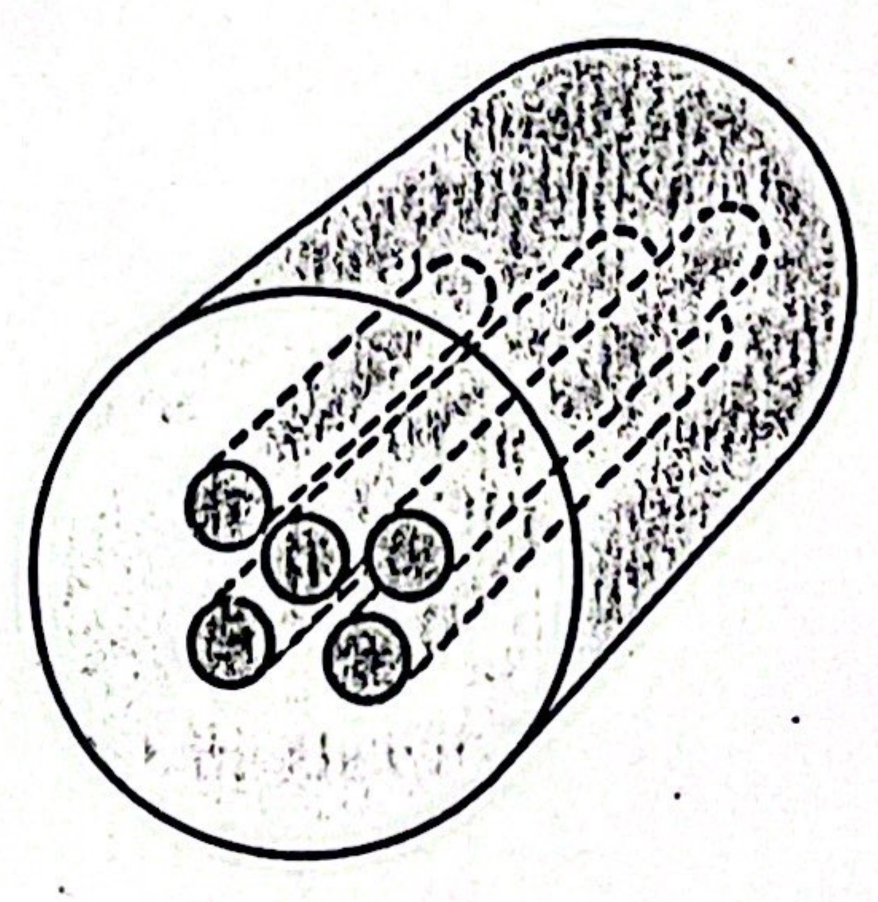
The shotgun strategy

Related diversifiers are less concerned with offering a tightly-integrated set of synergistic services than with growing a portfolio of offerings, often linked together loosely by electronic data processing networks. Deal making around the globe is of central importance to these firms, although different services may be targeted to different types of selected customers with different geographical scopes – regional, national, international. These firms may target high-end wholesale customers as well as providing services to retail customers. Citicorp would seem to be a prime example.

Institutions employing this strategy may try to provide a wide variety of products and services in as many sectors or geographic areas as regulation permits. Where regulatory barriers prohibit them from operating in a geographic area directly, they sometimes try to enter the market by acquiring a local company. There may, however, be little apparent integration among their different businesses.

We show the related diversifier's strategy as a cluster of circles of varying depths near the center of our cylinder. This may be thought of as a shotgun strategy, in the sense of trying to spray its effects across a certain band of the market through portfolios of financial products (*see* Exhibit IX). But it may also be thought of as a crystalline strategy, in the sense of growing one service onto another in a steady progression (although the latter metaphor implies more synergy among the various components than does the former).

Exhibit IX The shotgun strategy



A fascinating example of the shotgun strategy is the general approach pursued by the Hongkong and Shanghai Banking Corporation (HKB). It is the largest bank in Hong Kong, the owner of the second largest one, and the most active international bank in China. It operates additionally in North America and Europe, in retail, corporate, and investment banking. HKB's strategy has been to expand through strength in its basic businesses. It is a technological leader, particularly in retail banking, and uses a global data network to link all of its offices worldwide. Investment banking is another of its strengths, with ownership of several big players, including Wardley Holdings, James Capel, Carroll McEntee & McGinley. Other HKB businesses include insurance, retirement benefits, leasing and hire purchase, and trustee and nominee companies.

Finally, Banc One Corporation provides a rather good example of a related diversifier on a smaller scale. It has become one of the leading superregionals in the United States through an acquisition strategy spanning a decade, combined with an innovative use of technology.

Banc One owns 55 banking organizations operating in Ohio, Indiana, Wisconsin, Michigan, Kentucky, and Texas. Additionally, its subsidiaries offer financial services in the areas of mortgage banking, equipment leasing, consumer finance, fiduciary and trust services, credit life insurance, and discount stock brokerage. The organization's basic lending policies dictate that the great majority of commercial loans be made to small- and middle-market customers operating within the affiliate banks' market areas.

The industry called financial services

Our framework offers managers a way of visualizing how firms have tried to cope with a changing world of finance. It also provides a different way of looking at traditional businesses in an evolving financial services environment. They can use it to map the possibilities of different organizational structures, aligned according to businesses, customer segments, or geographies.

They can also use it to plot where their organizations fit, where gaps exist, and where competitors are likely to come from. Finally, the framework can be an effective tool for communicating an organization's strategy to employees, shareholders, and other interested constituencies. By making strategies visible, it makes them easier to talk about.

A final question: is there really a financial services industry? Years ago, in his article "Marketing Myopia," Theodore Levitt implored managers to look beyond their immediate businesses to the broader missions they served. Oil companies were to conceive of themselves as being in the energy industry, railroads in transportation. It is not clear that an energy industry ever emerged, but a transportation industry has surely never materialized. Few railroads run airlines, let alone taxicabs, and some that tried (such as Canadian Pacific) have given it up. Broad missions are concepts in the minds of people. Sometimes they remain just that – little more than dreams – and sometimes they do influence the behavior of organizations, though not always successfully.

Companies that pursue the strategies we have labelled disk, donut, and shotgun are betting that there is a financial services industry. Those with rifle shot, thin wedge, and chunk strategies are less committed to the concept. Only time will tell whose bets pay off. Our guess is that there will prove to be more than a banking business, more than a brokerage or an insurance business, but probably less than a fully-integrated financial services industry. Q

Maria Gonzalez is head of Competitive Strategy at the Royal Bank of Canada and is on the faculty of the Executive Development Program of the Management Institute at McGill University. *Henry Mintzberg* is Bronfman Professor of Management at McGill University and Visiting Professor at London Business School.