

*Securing the benefits of globalisation • Part III, Chapter 6***Insights  
from  
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## Securing the benefits from a global scale in financial services

In 2004, of the 50 largest financial institutions, 35 were headquartered in Europe, eight in the USA and six in Japan. The same year, seven out of the ten largest global financial services companies were headquartered in Europe, among which: Allianz, BNP Paribas, Crédit Agricole, Deutsche Bank, HSBC, ING, and UBS. The global insurance industry boasts a number of European brands as well: AIG, Aviva, AXA, Allianz and Generali, among others. Meanwhile, although the investment banking industry remains US-centric, the likes of Deutsche Bank, HSBC, Crédit Suisse and UBS (thanks to acquisitions of American banks) are surely rising Europe's visibility on this frontier. In practice, European financial institutions have been at the forefront of the globalisation process over the course of the past 25 years. However, most of them did not follow the same path as their American counterparts, and they internationalised their business within Europe first, owing to the comparatively greater complexity of doing business on the Continent versus in the US – different languages, regulations and currencies (before the adoption of the Euro).

**Securing the benefits of globalisation****GLOBALISATION METRICS**

We have focused our measurement on two samples.<sup>1</sup>

- *Top 30*: Top 25 banks and the Top 5 insurance companies headquartered in Europe, thus covering the 13 businesses lines in which European financial institutions operate (see Table 1).
- *Top 10*: Top 7 banks and the Top 3 insurance companies headquartered in Europe

Assisted by these stipulations, we intend to provide a snapshot of how the industry has evolved in recent years. Consistent with these intentions, the Top 30 and Top 10 result from samples taken in 1990, 2000 and 2003, a representative period of substantial mergers and acquisitions activity.

We have then created four aggregated indexes:

- *Top 30 Dimensions Indexes* for each of the nine dimensions for the Top 30,
- *Top 10 Dimensions Indexes* for each of the nine dimensions for the Top 10,
- *Top 30 Global Index* by averaging the nine metrics above for the Top 30 (10<sup>th</sup> metric, as expressed within Chart 1).
- *Top 10 Global Index* by averaging the nine metrics above for the Top 10 (10<sup>th</sup> metric, as expressed within Chart 2).

The nine dimensions are as follows (divided into relevant sub-categories):

*Geographic reach:*

1. Number of countries with corporate presence / total number of IMF countries excluding poorest (World Bank definition)

*Structure of ownership:*

2. Size of float / total equity capital
3. Number of foreign shareholders

*Global Management:*

4. Number of foreign board members
5. Number of foreign corporate officers
6. Number of foreign C-Level executives
7. Number of foreign business-line executives

*Brand:*

8. Number of countries operating with unique or twin brand / number of countries of operations

*Processes and infrastructure:*

9. Number of services centres / number of countries of operations

To create metrics for those dimensions, we have rated each of the above dimensions on a scale ranging from 1 for least global, to 5 for most global. The following measurements are quantitative, based upon simple percentage calculations

- i. Greater than, or equal to, 50% = 5
- ii. Between 40% and 49% = 4
- iii. Etc

<sup>1</sup> The globalisation metrics used here are based on various sources including annual reports produced by the Top financial institutions headquartered in Europe (by the size of their total assets).

Whether overcoming this diversity challenge was beneficial to European financial institutions, as it gave them more assets to undergo further levels of globalisation, or detrimental because of highly inhibitive barriers, remains an open question. This paper is rather focusing on the “hows”, rather than on the “whys”. What are the practical lessons learned from the globalisation of financial institutions during the past two and a half decades? How might they inflect our reading of the ongoing globalisation of the European financial services industry? Based on the experience of the past two decades, lessons learned from the globalisation of European financial institutions fall into three categories:

- In a multi-criteria analysis, European financial institutions have not yet fully completed their globalisation process;
- Globalisation of the European financial industry occurred across three waves in the past 25 years, but seems to have reached a plateau;
- There is not one, but several, approaches to globalisation – a recurring theme in this book. However, some common patterns can be identified across the European financial industry.

## Globalisation as an ongoing process

Although globalisation is often perceived to be a straightforward term, this perspective is misleading. Globalisation is indeed a multi-dimensional notion, extending far beyond the simple criterion of geographic reach.

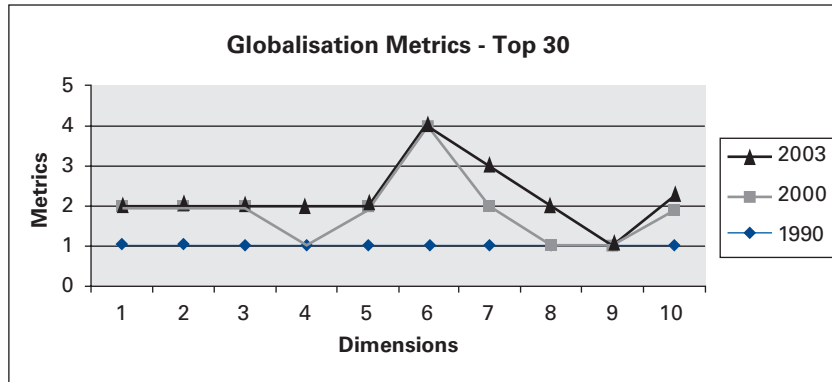
For the purpose of this paper, we have measured globalisation along nine main dimensions (see the Box: Globalisation Metrics).<sup>2</sup> Although we recognise that none of the individual metrics adequately reflect the level of globalisation within European financial institutions in Europe, in aggregate, they evoke some of its leading trends.

Charts 1 and 2, below, illustrate the globalisation process between 1990-2003. As conveyed, the European financial industry is hardly ‘global’ in all respects, especially in terms of management structure, processes and infrastructure, and governance.

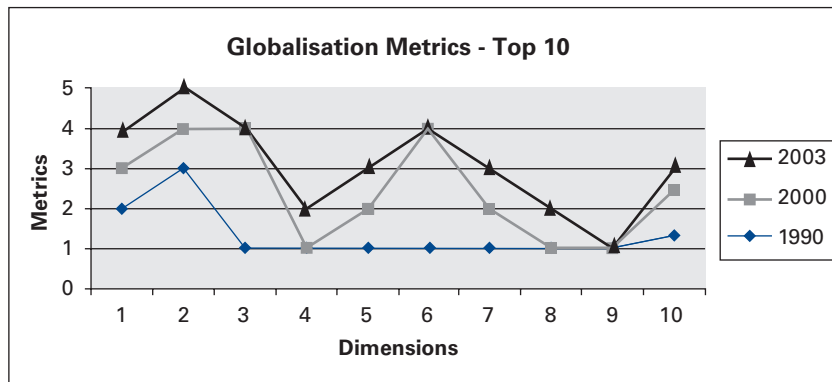
2. Admittedly, the various dimensions outlined here, or the 13 business lines in Table 1, could be considered arbitrary as they aggregate, and thus simplify, so many intricate factors. For instance, ‘corporate banking’, requires us to bundle business areas such as mergers & acquisitions, structured finance, corporate and syndicated lending, trade financing, and so on, under one unitary moniker. Similarly, ‘payments’ regroups diverse payment structures under a single category even though they are often operated as distinct businesses, or are run out of different business units, in many financial institutions. Despite such subjective shortcomings (i.e. how/why these selection criteria are advanced), and the generalisations they entail, we believe the benefits of these metrics exceed their drawbacks.

**Securing the benefits of globalisation**

**Chart 1**



**Chart 2**



In these charts, the metric of the Global Index (10<sup>th</sup> dimension) is the average of the 9 other metrics (see Box: Globalisation Metrics)

Let us now proceed with specific comments on the following three areas: business characteristics, geographic reach, structure of ownership and structure of management.

***Business characteristics & geographic reach***

The globalisation strategies of the various European financial players are intimately linked to the type of business lines they are in. Businesses 1-13 in Table 1, below, could obviously include many subdivisions, but can be generalised as increasingly 'local' as the list grows. Hence, corporations focusing

predominantly on businesses 1-6 are the most 'global', whilst those specialised on businesses 7-13 have a more multi-local emphasis.

**Table 1**  
**Main business lines in the financial industry**

1. Capital markets
2. Re-insurance
3. Securities (transactions processing)
4. Asset management
5. Private banking
6. Corporate banking
7. Consumer finance
8. Payments
9. Mortgage finance
10. Retail banking
11. Property and casualty insurance
12. Life and pensions insurance
13. Health insurance

With the exception of some re-insurance companies, which are, by essence, global, European financial institutions operate both in global and multi-local markets. They have grown global starting from local operations; their reach extended primarily through acquisitions, focused essentially at gaining a presence in London and in New York. This contrasts with the specialisation of the leading global US banks that, during the '90s, consolidated around large multi-local players in capital markets, securities, and asset management businesses (Citigroup, JP Morgan-Chase, *etcetera*).

The globalisation strategies of European players differed throughout the '90s: some were proponents of a 'retail at home, wholesale elsewhere' policy; others, especially insurers, were exclusively multi-local in their core business, in their efforts to expand their geographic reach. All in all, because they are essentially universal banks or insurance companies, none rate above 3 (in our metrics) in terms of geographic reach. This will, however, evolve over time, as the Eurozone (as well as Switzerland and Eastern Europe) is increasingly regarded as their domestic market.

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### ***Structure of ownership & structure of management***

Most European firms rate high in terms of their 'structure of ownership', as they are listed in various markets where international investment exceeds 40%. However, this does not always translate into the composition of Executive Boards. In recent years, governance practices at the Board level have become increasingly codified, thus tending to reduce management culture divergences across business entities. Yet, looking at the composition of Boards, of corporate officers and of executive teams in annual reports provides a fair view of the extent to which financial corporations are global in their management. And the result is, with very few exceptions, that the management is ever more local as one ascends the corporate hierarchy (i.e. UBS's Board of Directors is Swiss-dominated, while the next layer, the Group Executive Board, is not).

## **A globalisation process rolled out by waves**

Throughout Europe, banks usually conform to six categories: large 'private' banks, savings and loans, agricultural mutual banks, other mutual institutions, domestic Postbanks, and various niche players (usually local). By and large, only the first group's members qualify as 'global', although this is also the case for France's Crédit Agricole following its acquisition of Banque Indosuez (1996) and Crédit Lyonnais (2003).

The processes of globalisation have different degrees of attractiveness, and ease, depending on whether retail or wholesale businesses are concerned.

- In wholesale finance (capital markets, asset management, corporate finance, corporate insurance solutions, re-insurance), a sector characterised by its highly global clientele, the benefits of globalisation are founded upon the deregulation of capital movements. This sector's globalisation process started in the early '80s and has accelerated markedly ever since, mostly achieved through acquisitions, very often spectacular, though not always successful.
- In retail, the clients are mostly local and the benefits of globalisation (synergies) are more difficult to tackle. Hence the globalisation process started through a multi-local, acquisition-centric, approach. Significantly, retail synergies are much easier to realise domestically than internationally. This explains why the globalisation process in retail finance has essentially been predicated upon the ability to con-

## **Securing the benefits of globalisation**

solidate locally. Over the past 15 years, the following have all grown in this manner: AXA, UBS, Swiss Life, Santander, BBVA, Mapfre, Dexia, Fortis, ING, ABN Amro, Bank Austria, HBV, BNP Paribas. Of course, the degree to which domestic consolidation within Europe has occurred varies by country. Germany and France, currently the two biggest retail-banking markets in Continental Europe, are diametrically opposed from this standpoint:

- In Germany, domestic consolidation lags behind other European markets. Notably, market shares of the global private banks are less than half their French peers, while the savings and loans operators are still very scattered and their consolidation highly problematic. This might explain the current focus of the German markets on building 'utilities', (e.g. processing centres shared by various players).
- In France, after the acquisition of Crédit Lyonnais by Crédit Agricole, the reorganisation of the Caisses d'Épargne, and the consolidation of many niche players within domestic (SG, Crédit Mutuel, BNP Paribas) or European groups (ABN Amro, Fortis, ING, HSBC, UBS and Crédit Suisse), further retail banking consolidation appears limited. In fact, we believe it has reached a state where the only plausible restructuring activity would be a merger between BNP Paribas and SG, the emergence of La Poste as a full-fledged competitor to banks or a further consolidation in the mutual banks sector (not foreseen – given the structure of equity capital in the various mutual groups, the possibilities for cross-border operations appear limited).

From a broader perspective, it seems that European financial institutions had more homework (Euro I & II, Internet, Y2K) to do than their American peers, thus influencing a different type of consolidation. American financial institutions were much more specialised (focused on savings and credit) than European ones (universal banking). Having said this, American financial institutions tended to have the critical mass to expand their business within their domestic market and it was simpler to achieve this through mergers and acquisitions. By contrast, it has been far more laborious to achieve the necessary consolidations and synergies within European domestic markets to gain the critical mass for globalisation.

Further movements in the European market, domestic or cross-border, will entail dramatic changes in the local retail banking landscape. Indeed, organic

growth in European domestic markets cannot support large ambitions, while the synergies to be expected from local mergers are considered to be much greater than those potentially generated by cross-border consolidation. In such a configuration, cross-border expansion is apt to freeze, at least until some key local consolidations are completed.

Valid though this judgment may be, not all retail banks are content to limit themselves to the domestic frontier. For instance, Spanish banks are now quickly expanding beyond their traditional markets (Iberia and Latin America) and these motions could onset a ripple-affect throughout Europe. Initiatives such as the acquisition of Abbey National by Banco Santander, or the bid on Banca Nazionale del Lavoro by BBVA, may prompt other large European players to act – as they feel this is one of their last growth opportunities, or simply to avoid becoming prey themselves. From this perspective, current activity in Italy may be signalling the advent of a third wave of globalisation in Europe, thereby making it all the more important to learn from lessons of the recent past.

## Multiple approaches, common patterns en route to globalisation

Business executives of European financial institutions, and CEOs in particular, face similar dilemmas as their non-European counterparts. Some leading issues include:

- Increasing share value while investing for the future;
- Growing market share while preserving short-term profitability;
- Promoting and protecting brand identity in an increasingly open world;
- Improving or expanding customer service while optimising operating costs.

Globalisation can help reconcile objectives often considered to be mutually exclusive, but it also creates constraints of its own. The ability to deliver post-merger synergies is, for example, an extremely pressing issue as many firms' path to globalisation is almost exclusively based on acquisitions.

More fundamentally, as businesses expand internationally, the ability to secure the necessary business operations so as to optimise performance grows exponentially. European financial companies have approached this matter with varying levels of success, but almost all have placed emphasis on the same

## **Securing the benefits of globalisation**

three levers: infrastructure management, financial communication, and branding. By contrast, financial institutions tend to differ on items relating to global corporate governance, culture and values.

Lastly, one must recognise that most companies still face challenges in terms of risk management and operational excellence.

It is instructive to review where companies converge and diverge on these areas.

### ***Converging features: processes & infrastructure, financial communication, branding & marketing***

#### *Implementing quick wins in globalising processes and infrastructure*

The majority of global companies have engaged in programs yielding relatively fast cost savings. Leading this list is the establishment of a global sourcing / procurement function and the consolidation of IT infrastructure.

In a second stage, the centralisation of the management and maintenance of globally-distributed IT infrastructures – often accompanied with a consolidation of numerous servers – has also yielded ‘quick wins’. This consolidation process has frequently been accompanied by an outsourcing agreement with a global provider such as IBM, DELL, or Unisys (as is the case with AXA and BNP Paribas). In other instances, this process has taken the form of maintenance outsourcing of applications (AxaNet to Cap Gemini, Zurich Life to CSC), or full management of the portfolio, itself (Abbey Life and Phoenix outsourced to Unisys). Another move has been to create shared service centres for accounting and human resources support functions, but this is less frequent in the financial services sector than in other industries.

Besides activities that provide obvious value, and little resistance, from the various entities of the groups, financial institutions have yet to efficiently leverage their size in Europe. Three leading issues include:

- Consolidating multiple applicative platforms;
- Promoting systematic re-use of local developments;
- Implementing generalised operational risk management.

Similarly, most European financial companies still hesitate to promote a global sourcing model. HSBC, with its strong presence in Asia, appears to be the European leader in this domain. However, one of the first movers in this field was Deutsche Bank with its ‘smart sourcing’ approach. First, Deutsche Bank

differentiated the infrastructure services in 'make' or 'buy' clusters. In parallel, they analysed which of 'onshore', 'nearshore' or 'offshore' units could deliver the infrastructure service. This produced a matrix that distinguishes between services (like booking) that can be outsourced and / or delivered by an offshore unit, and those that cannot. In a number of countries in continental Europe, the notion of 'social responsibility' is still advanced to rationalise why global sourcing is not extensively considered.

#### *Financial communication*

Financial communication is the strongpoint of Europe's leading players in terms of meeting the needs of the global capital markets. This is so irrespective of the markets or business lines in which they operate. Indeed, global European financial institutions are listed companies, present in one stock exchange, if not two (in Europe and New York). In the past decade, European financial institutions have centralised and globalised their financial communication (at headquarters level). Although quarterly meetings of CEOs and their executive staff with panels of financial analysts are now standard practice, one should remember that 15 years ago, they were but marginal proceedings. Regulations following recent corporate scandals (Sarbanes-Oxley Act in the US, extending into Europe), as well as the consolidation of the external audit firms, have reinforced the importance of global financial communication and contributed to a strong codification of the practices to be pursued by corporate executives.

#### *Branding & marketing*

Corporations have gone to considerable lengths to design and implement their global branding strategies, which vary significantly from one firm to the next. AXA is exemplary in this respect. In France, its home market, AXA was the only name used shortly after it acquired UAP in 1996 (a strong brand name and a much larger company than AXA at the time). By contrast, in all other countries where AXA acquired a company with a strong brand name, the global branding strategy was implemented in 3 steps: the local brand was left intact for a while (Equitable, Colonia, Nichidan, Royal Belge), then a twin name was promoted (AXA Equitable, AXA Colonia, AXA Nichidan, AXA Royal Belge), and finally AXA's name became dominant (AXA Germany, AXA Japan, AXA Belgique) – the only exception being AXA Equitable in the US as Americans' awareness of Equitable remains much higher than AXA. By contrast, other corporations acquiring a strong brand name in a local market may prefer to

## **Securing the benefits of globalisation**

keep the local name as principal – SG is a shining example of this (ex its involvement with Komerčni Banca).

Another popular global branding practice of European financial institutions has been to replace developed names by acronyms, while keeping the original name for the home business – and only if this reference to a specific geography is meaningful (HSBC, UBS, SG). The purpose of this approach is to globalise the brand by eliminating any reference to the corporation's country of origin.

### ***Diverging governance approaches***

Global financial institutions' governance styles can be measured by the degree to which their operations and decision-making processes are centralised. Such models vary from 'everything is local, but...', to complete centralisation of all operational units, from business to finance, IT, and human resources. In this latter model, the 'field' only has to execute the global strategy, which, itself, is streamlined and controlled by strictly defined, and IT-supported, processes.

Few European financial institutions claim they implement a fully centralised model, which is more common with their US peers. Consequently, it is most pertinent to ask whether the level of centralisation is a product of a firm's maturity, or if it is dictated by organisational choices that vary from one company to the next. Evidence indicates that centralisation does, indeed, increase with the maturity of the globalisation process, especially in areas where the benefits from 'scaling-up' far outweigh the increases in complexity and risk associated with centralisation. Yet, the proper balance in centralisation is very strongly determined by the value that executives of a global company place on individual initiative and local business knowledge.

Because Europeans are accustomed to living with several cultures and languages – sometimes in the same country (as in Belgium, Spain or Switzerland) – it is unsurprising that European companies often exhibit lesser degrees of centralisation, valuing, instead, the notion of 'corporate entrepreneurs'. Within Europe, this has little to do with the type of industry (insurance or banking) or country (for instance Latin countries as opposed to Nordics) in which the company operates. Rather, centralisation is highly dependent on the company's culture.

### ***Permanent challenge: securing business operations***

Securing business operations remains a tough challenge for global companies.

Although companies were already familiar with the management of global capital market portfolios in the '80s, new challenges were introduced as the globalisation processes advanced. Could credit risk be managed like market risk? How could a client's cash flow be consolidated on a global basis? How to manage operational risk?<sup>3</sup> Whilst these questions inevitably introduce new difficulties, they equally offer novel, and more efficient, ways to diversify risk. Today, one of the most important challenges concerns how to comply with various, and often divergent, local regulations. Sarbanes-Oxley Act, Basle II or Solvency II, not withstanding new regulations regarding fund management, human resources, *etcetera*, illustrate the rising visibility of such issues in the banking industry.

For global companies, the challenge is to manage cost efficiently whilst maintaining a tolerable level of risk and delivering a target level of client satisfaction (often dubbed 'executing on the promise of the brand'). Alongside cost efficiency and risk management, thus stand client-service components, from reduced transaction time-cycles to enhanced and seamless channel integration, and so on.

Although leading financial institutions tend to be advanced in terms of their capital market and asset management operations – and, in some cases, global credit risk consolidation – many still struggle with global operational risk management. This not merely relates to the ability to develop strong internal models to value risk and associated capital needs, but so to the mitigation of overall risk level which exponentially increases as the openness of the system (IT security) and the complexity of the global organisation grow.

Platform and application consolidations are but one element of response to those challenges; outsourcing of IT risk surveillance globally (24 / 7) is another. However, securing business operations are growing challenges that global enterprises have to face today. The fragmentation of Europe makes this more challenging, and certainly more costly to European financial institutions, but this challenge is by no means specific to them.

3. See Hermann-Josef LAMBERTI, "Operational and regulatory consequences of absolute connectivity," p 133-143.

## Lessons learned from European financial institutions

Globalisation remains an ongoing process for European financial institutions. The lessons they have learned can be briefly summarised as follows.

1. Some *business units* are not worth globalising (when target clients are not global or do not value global service);
2. Some *segments of the value chain* are not worth globalising. Looking at the value chain through the distribution / utility model can give useful insights as per *what* can meaningfully be globalised;
3. The first steps toward globalisation are *infrastructure* and *procurement*;
4. Globalisation of *support processes* can be productive, but may result in ineffective duplications or unwarranted complexity (especially in a matrix organisation);
5. Globalisation can have increased effectiveness when well conceived *blueprints*, and associated critical metrics, enable customisation of core solutions to be implemented;
6. The balance of *governance* between centralisation and decentralisation must be defined pragmatically;
7. Securing the benefits from leveraging global size often fail at execution level, due to one, or several, of the following:
  - Inability to cope with local regulations;
  - Non-industrial approach to *transactions processing* (low maturity of distribution / utility model);
  - Complexity of addressing the problem of multiple IT platforms and various, and inconsistent, processes resulting from acquisitions;
  - Weak global corporate culture and shared values, coupled with resistance to loss of local control.

Because the processes of globalisation are often viewed harshly by local parties, successful global financial institutions should place emphasis on the following actions:

1. Sharing and promoting corporate values and vision;
2. Defining the ambition, the level of breakthrough and the pace of change;
3. Clearly displaying the risk profile and delegation of management authority framework;

4. Revisiting the existing corporate governance model, empowering teams, and setting an appropriate balance between centralisation / decentralisation, local / global;
5. Recognising and valuing diversity;
6. Blueprinting internal best practices and comparing them to external best practices
7. Defining 'Key Performance Indicators' (internal / external)
8. Launching 'quick wins' initiatives to create internal credibility and the acceptance of future consolidation initiatives.

**Securing the benefits of globalisation**



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