

## 6 Views of other interested parties

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## **Introduction**

6.1. We invited views from a wide range of third parties including financial institutions, consumer bodies, associations representing particular groups such as students and the socially disadvantaged, trade unions, advertising agencies, regional chambers of commerce, trade associations, academics, government departments, supermarkets, and shareholders of Lloyds TSB and Abbey National. We also received a number of unsolicited comments. This chapter summarizes the evidence we received. We held hearings with nine of these parties. On 30 March 2001 we held an open meeting—the first the CC had held during a commercial merger inquiry (for further details see Appendix 1.1). A webcast of the proceedings was placed on the CC web site and had received 192 visits by late May 2001.

## **Financial institutions**

### **Alliance & Leicester plc**

#### ***PCAs***

6.2. Alliance & Leicester said that superficially the market appeared to be intensely competitive because in recent years there had been a significant increase in the number of service providers. However, market concentration remained with the big four banks. There was unquestionably a resistance among customers to switch their accounts, mainly because of the inconvenience this could cause. The dominant position of the big four banks was underpinned further by the ability of new entrants to cherry-pick the PCA market, focusing primarily on what were considered to be the most profitable elements or on those customers who were seeking an Internet-based relationship. In choosing to exclude themselves from the mainstream PCA market, many smaller players were simply helping to perpetuate the status quo.

6.3. Commenting on its new PCA product (the Alliance Premier Account), Alliance & Leicester said that advertising to date had been relatively low key but it would soon be promoting its current account services more prominently. The campaign so far had achieved the expected success rates and Alliance & Leicester said that it was inconceivable that it would ‘scale down’ its efforts to grow in this market, as had been suggested to us. In contrast to the larger banks, it had increased its share of the PCA market and had performed strongly against other newer entrants. It told us that in 2000, for example, it had opened nearly 135,000 current accounts compared with 172,000 new branch-based accounts opened by Abbey National (which had over twice as many branches and was more than four times the size of Alliance & Leicester by market capitalization). With a greater critical mass of PCAs, Alliance & Leicester believed that it could be an even stronger competitor in this market.

#### ***Branch networks***

6.4. Alliance & Leicester believed that the presence of a strong branch network was a key element of the PCA service offering. Although some customers were content to rely on an Internet presence, for many, access to a high-street branch was a significant factor, again reinforcing the position of the big four banks which had the most well-developed branch networks.

6.5. Alliance & Leicester said that one consequence of further consolidation in the banking market would seem to be a contraction in branch networks; in its view, however, such contraction was inevitable regardless of consolidation. It believed that in the UK there were too many banks and too many branches, and that cost pressures would almost certainly lead to a continued fall in branch numbers—particularly if those pressures were exacerbated by any downturn in the economy.

6.6. Alliance & Leicester told us that it achieved UK-wide coverage with a network of 309 branches. Although it did not believe that networks of over 1,800 (as currently maintained by the major banks) would be reduced this far, there was clear scope for numbers to fall as takeup of technology, in particular the Internet and interactive digital television, increased. According to the Office for National Statistics, more than one-third of UK households could access the Internet at home by the end of 2000 (nearly four times the 1998 figure) and 23 per cent of these used the Internet for personal banking or financial investment.

## ***Banking services to SMEs***

6.7. Alliance & Leicester did not believe that the merger would have a significant impact on the SME market. Whilst the merged company's size and reach (in terms of branch network) would appear to enable it to attack this market, Abbey National was not seen as a major competitor for SME business. It was therefore unlikely that a combination of the two parties would have much effect on competition, either for participants in the sector, or for the customers.

## ***The merger***

6.8. Alliance & Leicester did not wish to make any comment on the public interest issues raised by the merger. It said that there had been much speculation as to the likely scale of future consolidation within the financial services industry in the UK, with Alliance & Leicester being a regular target of such speculation. In assessing the way forward it was important to balance issues of consumer choice with the position of the UK banking sector in the wider European and/or global context.

## **BoS**

6.9. BoS gave written evidence and attended a hearing. Commenting on its possible merger with Abbey National (discussions on which had been terminated in February 2001), BoS said it believed that the combination of its skills and Abbey National's branch network would have provided a significant new force in the market for all banking products, but particularly for PCAs and SME business. The merged company would have had the size, credibility and skills sets to offer real competition to the big four banks. BoS believed that the fact that Lloyds TSB had bid for Abbey National at the time when Abbey National had announced its merger discussions with BoS raised serious concerns over Lloyds TSB's motivation for the merger. BoS was still looking to create a fifth force in the market (and subsequently announced that it and Halifax had agreed the terms of a recommended merger).

## ***PCAs***

6.10. BoS said that it agreed with the conclusion of the Cruickshank report, and with the DGFT in his advice to the Secretary of State on the merger, that the PCA market should be seen as UK-wide. This was particularly because of the fact that charges and other terms and conditions for current accounts were generally set on a national basis.

6.11. BoS thought that a branch network was crucial in this market. Most new PCAs were opened by students and young people who were content to use the Internet for other purposes but preferred to discuss financial matters (often overdrafts) in person. BoS told us that it had made some incursion into personal banking markets in England and Wales through telephone banking and a number of joint ventures and partnerships, for example with Sainsbury. However, it had experienced limited success in making inroads into the PCA market in England and Wales because it did not have a branch network in those countries. Another important requirement for competition in the PCA market was a credible brand.

6.12. Although a number of smaller banks offered PCAs, their growth in this sector and their ability to provide a competitive constraint to the big four had been limited. Barriers to switching and lack of credibility as a trusted current account brand provided two of the main reasons for their limited growth.

6.13. BoS said that Abbey National was strongly committed to the PCA market as shown by its success relative to the other smaller players. While others were abandoning plans to tackle this market, Abbey National was increasing its efforts to win new customers, having announced that it intended to add one million current account customers to its existing customer base by the end of 2003. The fact that Egg, the most developed of the Internet banks, with access to significant resources and to the established customer base of the Prudential, had decided not to enter the market suggested that there was little prospect for other stand-alone Internet banks in this market.

## ***Banking services for SMEs***

6.14. BoS said that there were barriers to achieving real growth and scale in two sectors of the SME market, liquidity management services and general purpose business loans. These barriers included the requirement for a reputation for small business banking; a comprehensive branch network (for depositing cash and obtaining advice from bank managers with knowledge of the local economy); and access to employees with relevant skills, such as credit assessment and relationship management.

6.15. Abbey National currently lacked skills and experience in assessing the risk involved in running an overdraft facility but could overcome this by recruiting suitably-qualified staff, although this would be likely to be over the long term. BoS believed that Abbey National, despite its small share of the SME market, had the necessary attributes from which a significant new competitor could be created in this market. These attributes included: a comprehensive branch network; an estimated 16 million customers, many of whom would run SME businesses; strength as a current account provider which meant that it had the infrastructure to provide SMEs with overdrafts; and an existing relationship with many SME customers through its financing subsidiary, First National.

6.16. Abbey National had committed itself to acquiring a 5 per cent market share in five years and had advertised its SME accounts widely in the national press. The only other player outside the big four to have announced an intention to build its SME business was the Alliance & Leicester but it lacked the resources and the branch network to become a significant competitor. The resources of building societies such as Nationwide were unlikely to be used for entry to the SME market given the natural focus of such mutual societies on personal customers.

## ***Internet banking***

6.17. BoS said that there were two key barriers to the development of current account services provided by stand-alone Internet banks. The first was that, because convenience was an important factor in opening a current account, visiting a branch was often the first choice. It was also easier to open an account in person because of the identification rules. Although stand-alone Internet banks offered attractive interest rates, such rates did not outweigh the advantages of major multichannel banks, particularly as interest payable on PCAs offered minimal benefits to customers.

6.18. The second barrier related to concerns over the Internet itself. A number of stand-alone Internet banks had experienced service failures, which had left customers with no alternative banking channel. Such failures exacerbated concerns over security and privacy. Most importantly, the Internet was simply not as convenient as telephone-based banking for many consumers. As all the clearing banks provided an Internet-based service, there was little competitive advantage that stand-alone Internet banks could create.

6.19. BoS therefore did not see stand-alone Internet banks as a serious threat to the competitive position of the big four in the foreseeable future. Use of the Internet might, however, bring significant changes to the delivery of banking services to customers, to the extent that offering an Internet banking channel would be a prerequisite to a successful competitive strategy. Experience in the USA, where Internet usage was more developed and which often provided a good indication of future developments in the UK, supported these views.

## ***Quality of service***

6.20. On the question of measurement of quality of service, BoS said that there were several customer satisfaction surveys for personal banking, many prepared by, or on behalf of, the banks. There was a danger of subjectivity in these surveys. In particular, there were significant issues relating to consumers' interpretation of satisfaction, and their reactions in the event of dissatisfaction. As a result, it was difficult to attach credibility to any particular survey and impossible to make comparisons between them.

6.21. To provide satisfaction, a bank needed to demonstrate a customer-focused track record. BoS believed that Abbey National's investment in its branch network and staff demonstrated its recognition of this. Abbey National had a sales and service process in its branches that specifically focused on individual customer management, and allowed nationally-set sales and service parameters to be adapted to individual needs. Its success had prompted other banks to start similar initiatives.

## ***Brands***

6.22. BoS said that the two most important factors influencing a customer's choice of bank (in particular for current accounts) were convenience of branch location and personal recommendation. However, brand also played an important role. There was little to differentiate among the brands of the big four compared with, for example, the fast-moving consumer goods sector. However, a well-known and trusted name in the financial services sector was important to customers (particularly for current accounts). It took time and significant capital investment for other businesses to replicate the same feelings of trust, security and reliability. The need for these brand values acted as a barrier to new entrants. There was also a distinct inter-relationship between the existence of a comprehensive branch network and a trusted brand. BoS believed that the physical profile of branches enhanced brand recognition and underlined the solidity of a bank.

6.23. Building up a trusted brand took years, especially in a fiduciary relationship. Building up a comprehensive branch network was financially impractical today in terms of finding appropriate locations, the required capital investment, and time. BoS believed that Sainsbury's Bank had not yet proved that its supermarket presence could be a direct alternative to a branch network.

6.24. The degree of brand recognition for the big four banks as trusted PCA providers contributed to the lack of switching. Given that customers also cited the importance of a local branch when choosing their bank, it was clear why there was so little switching outside the big four. Abbey National had a trusted brand that it continued to develop to reach the level of acceptance enjoyed by the brands of the big four. It also had a comprehensive branch network. Both factors placed it in a firm competitive position.

## ***Switching***

6.25. BoS said that the perceived difficulty in switching PCAs was one of the main reasons why the four major banks had such a large share of that market. Abbey National was one of the few players trying to challenge this perception with the introduction of a service to make switching easier. To enable the Government's new measures to facilitate switching to deliver competition, there needed to be attractive and viable alternative PCA providers. Abbey National was one of the few credible alternatives.

## ***Alternative networks***

6.26. BoS believed that the Post Office network would not be a credible alternative for the provision of banking services. The Post Office would not be able to provide a full range of services, in particular advisory and relationship services. Even if it recruited staff qualified to give financial advice, customers would be unlikely to wish to discuss their financial affairs in a Post Office environment.

## ***The merger***

6.27. BoS said that the merger would have a serious effect on competition in both the PCA and SME markets. In addition to allowing further entrenchment of the major banks' already dominant position, this would indicate to potential new entrants that before they had fully developed their business they might be 'taken out' by a larger player. It could also lead the other major banks to feel the need to match Lloyds TSB's growth by their own acquisitions.

## ***PCAs***

6.28. The increase in Lloyds TSB's share of the PCA market would be significant and would increase its market power as the leading player in personal banking. More importantly, the merger would increase the collective share of the big four banks from 74 to 79 per cent. This further increase in concentration would increase the likelihood that competition between them would, at best, continue to be muted and selective. Indeed, since they would have even more to gain from any increase in their charges, the incentive to coordinate their behaviour rather than to compete would be strengthened. Increasing concentration in an already over-concentrated market would inevitably lead to yet further dampening of competition, even without collusion.

6.29. BoS said that in a concentrated market competition from firms with relatively small shares could act as a constraint on the market power of the leading firms, particularly where such firms introduced low-cost methods of operation or product innovations. In personal banking, apart from the major banks, the ex-building societies were key players. Abbey National and Halifax were the most significant of these and both had national branch networks (a resource which could not be replaced once taken over by one of the major banks). The fact that Abbey National was just one of two national players, together with Halifax, outside the big four which had achieved a current account market share in excess of 5 per cent showed how committed and successful Abbey National had been in tackling the big four. Indeed, this combination of commitment to competition in PCAs and a comprehensive branch network gave Abbey National a special status from which significant new competition could be introduced into the current account market. The merger would prevent Abbey National from combining with another financial institution with strong banking skills outside the big four banks to create an enhanced and immediate challenge to the status quo. Abbey National's innovations had benefited customer choice. For example, it had recently introduced a branch-based current account with an interest-free overdraft for the first year and it had been the first bank to offer customers banking services through interactive digital television.

6.30. The merger would also remove from the PCA market a player with a different background and perspective towards banking markets from most of its competitors. Abbey National's origins as a building society had given it a strong focus on personal as opposed to business/corporate customers, whereas most traditional banks had a broad spread of customers across all sectors. Abbey National's focus on the personal customer had led it to concentrate particularly on providing a customer-friendly interface. This aspect might be lost as a result of the merger.

#### *Other personal banking markets*

6.31. The merger would lead to Lloyds TSB increasing its market shares across a range of other product markets. In addition to its leading position in the PCA market, it would be the market leader in savings accounts; the second largest in personal loans; the market leader in independent point-of-sale finance for both new and used cars; the market leader in mortgages; and the second largest in life assurance/pensions. BoS was concerned about Lloyds TSB's ability to cross-sell from one product sector to another. The ability of Abbey National to sell from its traditional product strengths (deposits and mortgages) into other areas such as current accounts might have beneficial effects on competition. However, the combined company would have a large share of PCAs. To the extent that the PCA market was characterized by low levels of switching, the merged company's PCA customers would be effectively captive. For reasons of convenience and/or lack of shopping around, these customers would be likely to obtain additional products from the same provider. In addition, the degree of overlap in mortgages between Lloyds TSB and Abbey National would give the combined entity a leading market position, raising similar concerns over the combined entity's ability to sell into other product sectors such as life assurance where there was also significant overlap.

#### *SMEs*

6.32. BoS said that the merger would remove one of the big four's main potential competitors in this market. If the merger did not take place, Abbey National could achieve accelerated growth through entering a joint venture or merging with another institution, or it could still meet its stated aim in this market by recruiting employees with the requisite skills, although this would be over the longer term.

#### *Branch availability*

6.33. Significant branch rationalization would be unavoidable if Lloyds TSB were to achieve its anticipated cost savings. In addition to restricting consumer choice this could have adverse social consequences for local communities. Lloyds TSB had announced that Abbey National branches would not be closed for two years but this would merely delay the inevitable. In five of the areas where a Lloyds TSB branch and an Abbey National branch were within 0.25 miles of one another, there would be no remaining competitor after the merger and in ten there would be only one competitor. Moreover, the vast majority of Abbey National branches were open on Saturdays, providing a customer service that could well be at risk.

## *Job losses*

6.34. It was estimated that 9,000 jobs would be lost as a result of the merger. BoS understood that the Lloyds TSB internal banking union had been persuaded to support the merger, but BoS was not aware of any assurances from Lloyds TSB as to where the job losses would fall. The natural assumption resulting from the support of the internal union was that the significant losses would fall on Abbey National's workforce. Although job losses as a result of a merger were not necessarily objectionable from a public interest point of view, this was another factor that the CC should take into consideration.

## ***Remedies***

6.35. BoS did not believe that there were any behavioural remedies that would alleviate its concerns about the merger. Although prohibiting the closure of branches for a specified period might limit the initial detriment, such a proposal would only delay the damage and might actually benefit Lloyds TSB in giving it time to sort out systems etc. Retaining the Abbey National brand name would not in reality have any effect. The branches would still be part of Lloyds TSB and would not compete as an independent company would. BoS therefore believed that the merger should be prohibited.

## **Barclays PLC**

6.36. Barclays gave written and oral evidence. Commenting on its merger with Woolwich, it said that the main benefits of the acquisition had been Woolwich's product and systems capability, as well as its brand. Woolwich had had a stronger mortgage proposition in terms of brand value and product than Barclays had, particularly as a result of its traditional building society image. In the financial services market, although price was important, brand values were also significant to customers. Barclays was continuing to use the Woolwich brand and to keep separate Woolwich outlets. It was now able to offer an innovative product to its existing customers and to introduce some Barclays products to existing Woolwich customers.

6.37. Barclays did not consider that 'best buy' tables were necessarily an accurate measure as they were not always based on all the criteria on which customers made a choice. Barclays said that it aimed to provide good value for money. Price was a very important consideration, along with various other aspects of the products and services in different market sectors. In marketing personal loans, for example, Barclays used personal pricing which reflected the particular risks involved with the customer concerned, ensuring that it provided the best price based on individual behaviour. Barclays also told us that in 1998 it had been the first bank to allow personal customers to make immediate withdrawals against cheques paid in (rather than the customers having to wait several days for them to be cleared). No other bank had followed for three years. Although its market share was obviously important, Barclays did not set market share targets as such. It was more interested in growing customer value and incentivized its staff on that basis.

6.38. Barclays believed that there were many and varied strong competitors in all sectors of the financial services market, including the PCA sector. Although some players, for example Internet banks, might not be successful across the whole market, there were niche markets where they would succeed.

## ***PCAs***

6.39. Barclays told us that PCAs generated less net income per customer than mortgages or personal loans, but more net income per customer than credit cards (where net income was defined as total income less risk costs). One of its aims in this market was to encourage younger people to open PCAs with Barclays. It saw a PCA as one of a number of entry points to Barclays' services. Although simplistic estimates of switching had been quoted at 2 per cent, Barclays believed that this was an inaccurate measure of switching activity. It was easy to open PCAs and many customers had accounts with more than one bank, choosing which transactions to undertake with each. Switching was as easy as choosing to write a cheque from one account rather than the other. Barclays saw PCAs as part of a wider personal financial services market, and it believed this was how the market should be defined. Barclays saw difficulties in introducing 'portable' account numbers and did not believe that such a measure would increase switching by customers.

6.40. Barclays did not agree with the suggestion that there was little price competition between the four big banks for existing PCA customers, with all initiatives coming from the small players. Price competition had, for example, driven money transmission charges to zero for many accounts. Price competition in the form of interest paid on PCAs had to be understood correctly. Barclays pointed out that the 4 per cent interest rate on credit balances offered by Halifax, for example, was subject to restrictive conditions. Barclays had adopted a different approach and was constantly looking for ways to improve its customers' products. For example, customers with £1,000 in a PCA who communicated with Barclays face-to-face or by telephone were encouraged to transfer money into a savings account with a better rate of interest. Barclays emphasized that it did not discriminate among its customers by offering products with restrictive conditions, or limiting the availability of new products.

### ***Banking services for SMEs***

6.41. Barclays believed that the market for SME banking was a national one, in which financial institutions and other organizations competed with the clearing banks. In particular regions there was fierce competition from regional players, for example Yorkshire Bank. Customers switched between alternatives, both products and providers, assessing relative product prices and other features. Although many customers valued the accessibility of a local branch for cash handling, overlapping branch catchment areas precluded local segmentation. In addition many other customers were less sensitive to location.

6.42. As in other sectors, Barclays aimed to increase service and standards to SMEs. It carried out 96,000 telephone interviews annually in order to measure customer satisfaction. Its surveys showed that 95 per cent of its SME customers rated Barclays' service as good or excellent.

### ***Profitability***

6.43. Barclays believed that the Cruickshank report was fundamentally wrong in its measure of profitability. Barclays said that it had presented a methodology to the Cruickshank team which showed that over ten years it was the forty-fourth most profitable company in the FTSE 100. It believed this indicated that, if Barclays was making excess profits, then so were half the firms in the FTSE 100. This was not sustainable. A simple measure of profitability was to see how the returns above the cost of capital, measured over an extended period, compared with those in other industry sectors.

### ***Alternative networks***

6.44. Barclays foresaw the increasing delivery of financial services by alternative means. Tesco was one example of a number of companies that were facilitating this. It believed that branch networks would continue to play an important part in customer access channels, but that they would be combined with other channels.

### ***Abbey National***

6.45. Barclays said that Abbey National was a strong and well-established competitor in the personal and, increasingly, SME markets. It had launched a number of initiatives but it was too soon to comment on the extent to which those initiatives might be successful.

### ***The merger***

6.46. Barclays said that it did not believe it appropriate to comment on its competitors' actions.

## ***Remedies***

6.47. Commenting on the workability of possible hypothetical remedies, Barclays said that divestment of businesses could be very difficult to carry out in practice. Divestment of branches was, in itself, relatively simple but divesting or transferring customers was not, and would be unattractive and impractical.

6.48. Barclays believed that there was a need for effective competition in banking services to UK personal and business customers and that the conditions for this already existed; but in general, markets were better in ensuring competition than were regulators.

## **Halifax Group plc**

6.49. Halifax gave written evidence and attended a hearing. It said that it had about 800 branches and, apart from some reduction in the number of outlets as a result of its acquisition of Birmingham Midshires, it had made no significant closures and did not plan to. Halifax believed that its network was the right size for nationwide coverage. For historical reasons, its branches were generally in more suitable locations than those of the clearing banks and of a more appropriate size. It said that it had tended to pursue a strategy of acquisitions that brought it new channels of distribution in products that became available, for example long-term savings, and management capability.

6.50. Halifax said that its strategy was increasingly consumer-led. It sought to win new customers by providing value-for-money products in the most challenging way possible and to retain those customers by continuing to provide a better deal. Halifax aimed to increase its share of the new mortgage market in 2001 from 10 to 15 per cent and over the next three years to double its shares of the credit card and PCA markets, solely through organic growth. Although this strategy initially led to a drop in profit, Halifax believed it was the best way to deliver growth in terms of customer relationships and to increase shareholder value.

6.51. Halifax considered the retail financial services market to be national because, as far as it was aware, products were priced at a national level. The market had a more consumerist and retailing character than ever before as customers were demanding value-for-money products and would continue to do so. Relying on inertial sources of profits (the bedrock of retail financial services, particularly banking, for about the last ten years) was not a sensible strategy to adopt. There were three things that determined competition: pricing transparency, the ease of switching from one bank to another and reality of choice (which in respect of PCAs probably meant on the high street rather than remotely). As emphasized in the Cruickshank report, the areas with the most established, aggressive and far-reaching competition were the mortgages and savings sectors and there was no sign that the intensity of that competition was lessening. Halifax said that its announcement in February 2001 about its benchmark variable rate had quickly been followed by a number of other lenders. Elsewhere in retail financial services, especially in the traditional retail banking markets, competition was, at best, variable. Halifax said that it appeared to provide the main competition in those markets, with Nationwide and the smaller Internet and telephone banking operations competing in particular product areas.

## ***PCAs***

6.52. Halifax said that the major banks appeared to operate a fairly uniform approach to pricing, particularly in the PCA sector which was probably the least competitive sector in the retail financial services market, especially for products sold on the high street. It noted that, four months after it had announced that it was offering 4 per cent interest on PCA credit balances, none of the other banks had made competing offers.

6.53. In the past, customers had been unlikely to change their PCAs but Halifax believed that, in their search for better value products, they were now seeking to do so. Its research showed that, if portability were made easier, for a higher rate of interest potentially up to 15 million consumers would move their PCAs to another provider over time. It was essential that the industry-wide automated current account switching system worked adequately. Without this there would always be a limit to the effectiveness of competition in the PCA market, as few organizations believed that they could break into the

sector on value alone. However, Halifax said it had shown that was possible: in the first two months of 2001 it had received 100,000 applications for PCAs, both first accounts and by transfer from other banks. Halifax believed that, although it had not traditionally been seen as a PCA provider, its new current account launched in January 2001 had introduced significant customer choice and changed its brand image. During the first four months of 2001 it had opened three times the number of PCAs that it had in the same period in 2000. PCA closures during that period had dropped by almost 20 per cent compared with 2000. Although the 4 per cent interest rate had been a major reason for the change, Halifax's research had shown that a significant number of customers had not known that it offered PCAs. Halifax said that it now had first place in terms of consumers' preference for PCAs with, it estimated, about 5 per cent of the PCA market which it aimed to increase to about 12 per cent in the next two to three years.

6.54. Halifax saw PCAs as an opportunity to develop relationships with customers and cross-sell other products, particularly credit cards and personal loans. In general it would expect to sell one other product within a few months of a customer opening a PCA. Despite the growth in telephone and Internet banking, Halifax believed that PCA customers still needed the security and reassurance of potential branch access. Although it expected a continuing rapid increase in remote banking, Halifax thought that in ten years' time 75 per cent of customers would still require a branch distribution system.

### ***Alternative networks***

6.55. We asked Halifax whether it thought that other retail outlets could be adequate substitutes for banks. It said that Post Office branches would be limited in the transactions they could carry out, probably no more than could be done through ATMs. Halifax had initially seen supermarkets as potentially powerful competition. However, the economics of establishing a retail franchise in banking would require substantial financial losses which supermarkets, essentially food retailing outlets, did not seem to be willing or able to make. In addition, banks were selling a range of value-added products, for example long-term savings and insurance products, and such products required trained, high-calibre staff. Supermarkets did not have access to such staff so would be unable to compete effectively. If they chose to give space to banks within their outlets rather than managing their own banking services, the position might be different. Halifax thought that the entry route for insurance companies, which had limited branch networks, would fundamentally be through remote channels. It said that competition, including from Halifax itself, meant that such entry routes were not as accessible as they had been a few years ago and building a business by such means would be difficult.

### ***Mortgages***

6.56. Halifax said that new entrants to the mortgage market had been able to come in through other channels. One of the reasons why the mortgage sector was much more competitive than the PCA sector was the fact that mortgages could be arranged over the phone, removing the need for a branch network. Halifax told us that whereas three years previously its stance had been to react to competition in the mortgage sector, it was now more of a price setter. Over 30 per cent of mortgage business was remortgaging and as the market leader Halifax was actively trying to reduce the disparity between 'front book' and 'back book' pricing in order to retain customers. As with PCAs, mortgages provided the opportunity to cross-sell other products.

### ***Banking services for SMEs***

6.57. Halifax said that it was difficult to enter the SME sector. Distribution in this sector required management and systems capability rather than a traditional branch network. Such branches as were necessary had moved to business parks. If the merger went ahead, it would not affect Halifax's aim to enter the SME sector. So far, however, Halifax had not taken active steps towards realizing this aim.

### ***Personal loans and credit cards***

6.58. Halifax said that competition was increasing in the personal loan and credit card sectors of the market, where Halifax played a significant role with a number of competitive products.

## ***Profitability***

6.59. Halifax agreed with the suggestions in the Cruickshank report that the level of profitability of the traditional clearing banks implied that their core markets were not competitive. Although the major banks' margins had probably fallen over the last two years, there was still a considerable way for them to go. Halifax said that offering 0.1 per cent interest on PCA credit balances in combination with high overdraft rates and high charges was very profitable. PCAs which provided a good return to customers and a competitive overdraft rate, such as those offered by Halifax, were not especially profitable in their own right.

## ***Lloyds TSB and Abbey National***

6.60. Halifax said that Lloyds TSB had not taken any initiatives on mortgages or savings accounts. Halifax's brand research indicated that, as a consumer brand, Abbey National was 'centre back' and not as powerful or as highly rated as the Lloyds TSB brand. Abbey National had the residues of a building society and was not distinctly differentiated in other ways.

## ***The merger***

6.61. Halifax said that it did not have a corporate view on the merger. If the merger were found to limit competition in the PCA and SME sectors, it would be against the public interest.

## ***Remedies***

6.62. Halifax did not generally favour behavioural remedies, believing that the best course of action was either to allow a merger to proceed or to prohibit it.

## **HSBC Holdings plc**

6.63. HSBC said that it operated in a number of geographic markets worldwide and believed that the UK market for retail banking services was highly competitive, with a large number of competitors in each sector. Banks competed on price, service quality and the relative balance between the two. In addition to traditional branch-based banking, there were important new forms of remote banking via the telephone or the Internet.

6.64. HSBC considered that Lloyds TSB and Abbey National were strong competitors for both personal and SME banking business. However, they were only two among a number of product providers. Competition came from many sources, including banks, former and existing building societies, and new Internet banks. In addition, there were several organizations, including the major supermarkets, which provided banking products to personal and SME customers. HSBC said that customer satisfaction was high and it did not believe that there were any barriers preventing the entry of others to the relevant market sectors. It did not consider that the proposed merger was likely to give rise to any adverse public interest consequences.

## **Nationwide Building Society**

6.65. Nationwide gave written and oral evidence. It said that as a building society, unlike a bank, its customers were its main motivation rather than profit maximization although, of course, it had to make sufficient profit to run the business. Nationwide's traditional role as a savings and mortgage provider had changed and it now competed with the major banks in offering products across the whole personal financial services market.

6.66. Nationwide saw the retail financial services market as a national one because pricing was national. It said that one of the difficulties consumers had in considering competing offers was that products and pricing were not comparable; for example there were currently around 1,600 different savings accounts on offer, twice the number that had been available five years ago. Competition should be encouraged and the consumer offered genuine choice with greater transparency.

### ***PCAs***

6.67. Nationwide had entered the PCA market in 1987 in order to offer the complete range of personal financial services. It said that the market was dominated by the big four banks which did not compete on price or product, although they might compete on image. Consumer inertia made it difficult to win customers, particularly because they did not generally see building societies as PCA providers. Nationwide considered PCAs to be a gateway product and estimated that its PCA customers on average had at least one of its other products. Nationwide told us that PCAs were only marginally profitable for it but would be clearly profitable if it paid only 0.1 per cent on credit balances. In line with its general strategy, Nationwide looked at its overall product offering rather than profit.

### ***Mortgages***

6.68. Nationwide said that the mortgage market comprised two sectors: the back book, which was totally inert, and the front book, which was highly competitive—so competitive that business was probably uneconomic at the time it was written. Nationwide had recently introduced what was effectively a flat rate mortgage and had transferred existing customers to this product. Its competitors charged low rates to new customers but continued to charge higher rates to their back book customers. When new mortgage products were introduced their old customers would have to apply for them. Nationwide said that this practice was carried out to maximize profits.

### ***Alternative networks***

6.69. Nationwide said that although the use of other channels (for example, ATMs, Internet and telephone banking) was increasing, branches were still the main conduit for cash and inward payment transactions. Internet and supermarket banks had gained only a small market share and any impact they had had was very much at the margin. Although it had received an approach from one of these parties, Nationwide was not interested in a joint venture, believing that these organizations' profit-motivated philosophy was not appropriate to Nationwide. The company said that it was a leader in Internet banking, which was an integral part of its main customer proposition.

### ***The merger***

6.70. Nationwide believed that the merger would result in fewer competitors, fewer products and fewer branches. It said that the enlarged Lloyds TSB would control one in seven savings accounts, one in four mortgages and almost one in three PCAs. The reduction in choice and diversity, together with increased market concentration, would be detrimental to competition, innovation and the best interests of consumers. Business customers would also suffer a reduction in choice. This could only aggravate the situation in the SME banking market which, according to the CC's preliminary findings in its current inquiry into the supply of banking services, was already subject to monopolistic behaviour.

### ***Consumer choice***

6.71. The merger would result in the elimination of a major high street presence which would have an adverse effect on consumer choice and competition. It was unlikely that Lloyds TSB would retain both the Cheltenham & Gloucester and Abbey National brands in the long term, and equally unlikely that it would want to maintain the Scottish Widows, Scottish Provident and Scottish Mutual brands. It had already been announced that up to 600 Abbey National branches were likely to disappear as a result of the merger.

### *Mortgages*

6.72. Nationwide said that the merged company would have 23 per cent of outstanding mortgage balances, with net new lending only slightly lower (at 20 per cent of the market based on current performance). This would put the company in a powerful position in a market with high levels of consumer inertia.

### *PCAs*

6.73. The merged company would have about 28 per cent of the PCA market. Removal of one of Lloyds TSB's main competitors would reduce consumer choice in a market with well-documented levels of consumer inertia.

### *Savings accounts*

6.74. The merged company would have 15 per cent of the savings market which would make it the market leader.

### *Secondary markets*

6.75. The merged company would also gain market leadership in many secondary products such as niche lending and specific insurance products, as well as gaining strong market shares in unsecured lending and credit card markets.

### *Barriers to entry*

6.76. Market leadership in so many personal finance sectors would put Lloyds TSB in a position where it would be able to erect barriers to entry. Competition and innovation might be stifled if it were to confine competitive or even loss-leading pricing to new business, while maintaining its margins by charging higher rates to existing customers.

### ***Remedies***

6.77. Nationwide said that it would be difficult to impose behavioural conditions that would address the adverse effects of the merger. If the merger were to proceed, conditions should be applied that reduced the merged company's market share dominance in key markets to ensure that it could not exert undue influence in pricing.

## **Other financial institutions**

### **Bradford and Bingley plc**

6.78. Bradford and Bingley plc (Bradford and Bingley) said that it operated in the areas of mortgages, savings products and financial advice and believed it unlikely that the merger would have a negative impact on competition in these areas. There was intense competition in the mortgage market because there was little to prevent customers from moving their mortgages to other providers. Bradford & Bingley said that neither Lloyds TSB nor Abbey National was a market leader in the savings market and neither provided independent financial advice as part of its mainstream service.

### **John Davies Investment & Mortgage Services**

6.79. John Davies Investment & Mortgage Services (John Davies), an IFA, said that in its experience when a large financial organization grew as a result of a merger, service invariably suffered. It cited

examples of firms which had previously had good track records of customer care whose administration had deteriorated so much after they were taken over that John Davies and other IFAs no longer dealt with them.

## **Norwich and Peterborough Building Society**

6.80. Norwich and Peterborough Building Society, which operates in East Anglia and Lincolnshire, told us that the merger would have a significant effect on competition in this region. Lloyds TSB currently had the second largest branch network comprising 117 branches compared with Barclays' 135 branches. The merger would make it the largest. In addition, Barclays' business was biased towards the corporate banking market rather than to personal banking. Lloyds TSB already had a large share of the personal banking market in the region and the merger would strengthen this further.

## **Consumer bodies**

### **Campaign for Community Banking Services**

6.81. The Campaign for Community Banking Services (CCBS) said that the major banks dominated the market, with 90 per cent of SME business and 70 per cent of PCAs. These banks behaved in an almost identical manner in matters of branch representation, opening hours, clearing times, organizational structure, charges and lending criteria. Any distinctiveness and innovation tended to come from smaller players.

6.82. The CCBS said that the unique qualities of TSB had disappeared after its acquisition by Lloyds Bank and absorption into the 'Lloyds formula'. Since Cheltenham & Gloucester had merged with Lloyds TSB, it was losing market share of new mortgages because its rates had become less competitive. Although Abbey National had not always acted in the consumers' interest, the CCBS believed that it had displayed innovation in some matters, for example branch franchising, outsourcing ownership of its property portfolio and some processing (and the introduction of coffee bars). Even more significantly, its July 2000 announcement that it intended to widen its SME services had indicated that it was becoming a real competitor in that area.

6.83. The CCBS said that the SME market remained very branch dependent: a recent survey for the BBA had indicated that 70 per cent of businesses visited a bank branch at least weekly and 8 per cent did so daily. Abbey National was one of very few (Halifax and Nationwide being the others) that could realistically compete with the big four in markets which remained branch dependent. If the merger went ahead Abbey National would disappear as a competitor and innovator. Also, the acquisition could give a signal to the other major banks that could lead to the disappearance of Halifax and Nationwide.

6.84. The CCBS was also concerned that the merger would lead to a further concentration of branches and of decision-makers in the enlarged Lloyds TSB who lacked knowledge of the needs of people at a local level and the issues that concerned them. This was particularly likely in smaller and poorer communities rendered even more marginal to the enlarged company's total financial performance. The impact on communities of the loss of local bank branches contributed to inconvenience, hardship, financial exclusion, the closure of other local businesses and increased environmental pollution from unnecessary travelling.

6.85. The CCBS said that, given the nature of the business concerned, it could not envisage any appropriate safeguards that could be imposed if the merger went ahead. Behavioural remedies were notoriously difficult to monitor and enforce. Lloyds TSB's record was one of absorbing similar acquisitions even if, as in the case of Cheltenham & Gloucester, it retained the brand.

6.86. The CCBS drew to our attention its proposals that a network of multibank agency outlets should be provided that allowed basic access (counter and terminal services) for business, individual and voluntary-body customers of all major banks, and charged the same amount for all services. This, it said, would allow for a neutral delivery channel for competitive products.

## Consumers' Association

6.87. CA gave written evidence and attended a hearing. It also played an active part in the open meeting.

6.88. CA said that it had a dedicated team researching banking and banking products. Its work included a recent survey into *Which?* readers' views about changing current accounts, and regular (usually annual) product surveys. In addition CA's customer service centre received about 200 communications a month on financial matters, many of which concerned banking or banking products.

6.89. CA believed that there had been little improvement in the ways in which banks dealt with their customers and said that data indicating satisfaction should be treated cautiously. The banks' own surveys indicated that 90 per cent of consumers were satisfied with their banks. However, CA said that its surveys showed similar results to those of the banks when consumers were asked how satisfied they were, but when asked if they would recommend their bank to others, a different picture emerged. In a survey which CA had carried out in April 2000, Lloyds TSB was among the five banks with the lowest scores for the proportion of respondents who would definitely recommend their provider to a friend (27 per cent) and in the five highest for the proportion who would definitely not recommend their provider (15 per cent) (in each case the other four were NatWest, Barclays, Halifax and Clydesdale).

6.90. CA said that it agreed with the DGFT's view that the stock of current accounts was the key indicator of competition in the market. Lloyds TSB, in particular, had argued that the market for new PCAs was a better measure of competition and a more accurate indicator of future trends but CA's own analysis of the market led it to conclude that the difference in competition between stock and new PCAs was relatively slight.

### *New current accounts*

6.91. CA told us that the lack of public, comprehensive data on the PCA and related markets had forced it to combine data from different sources in order to estimate the market share for new PCAs. Although this might have some effect on the robustness of the data, CA believed that its analysis provided a useful estimate of market share. Its calculations indicated that in the year to March 2000 the RBS Group (including Virgin Direct and NatWest in 2000) accounted for 19 per cent of the total number of new accounts opened, Barclays (including Woolwich in 2000) accounted for 18.8 per cent, Lloyds TSB for 18.5 per cent and HSBC (including First Direct) for 14.3 per cent.

6.92. CA said that the largest segment of the new PCA market was that relating to first-ever accounts (which were usually opened by students and other young consumers). The key dynamic in the market was the fact that the cost of choice for the consumer could be assumed to be the same irrespective of institution. Whereas a consumer switching accounts from one bank to another might incur different costs (both financial and psychological), the new entrant would incur the same sort of costs irrespective of the institution chosen. There was probably little that the institution could do (outside the Internet environment) to distinguish its service as a bank from that of its rivals. Key factors in this market were access to basic facilities and network benefits, access to branch networks, risk avoidance and brand recognition.

6.93. Consumers switching to another bank made up the second-largest segment of the new PCA market. Because such consumers already had PCAs, they would have to calculate both the benefits of the products and services on offer and the cost of moving their account. CA said that this calculation was almost impossible to make rationally, forcing the consumer to use either proxy measures or irrational bases for the decision. Competition in PCAs was, therefore, likely to be based increasingly on non-price indications. So CA did not think that switching as it was currently structured could effectively provide competitive pressure for the big four banks. Although it welcomed moves to improve the mechanisms of switching, it did not believe that this would have much effect on the number of consumers switching accounts. Even if it did, the current lack of competitive pressure which allowed the big four banks to offer significantly different interest rates on PCAs was unlikely to be enhanced by an improvement in the mechanism of switching.

6.94. The third segment of the market for new PCAs concerned internal switching. Banks held customer information which enabled them to recognize which consumers were more likely to change to another bank and those from whom more favourable margins were earned. The banks could then trade up the customers they did not wish to lose. In effect they were offering an internal transfer without any of

the costs associated with external transfer. Trading consumers up the product chain allowed for targeted efforts to minimize defections to other banks. CA said that the competitive response of a number of banks to the increase in competitive offering from new entrants had been to fragment the account offering and segment the market. (Lloyds TSB, it said, appeared to be particularly successful at this.) It had allowed a degree of price discrimination in charges and fees between customers that enabled them to blunt the impact of the desire to switch. CA thought that the merged company would be able to segment the market even more effectively and blunt the impact of recent entrants. If the merger went ahead, CA expected that the other major banks would follow suit. This would lead to a situation where the appearance of competition (through brands) outweighed its vigour.

6.95. CA said that its analysis of market share figures showed that Barclays had increased its share of the new PCA market from 14 per cent in March 1996 to 23 per cent in March 2000. Given that one of Lloyds TSB's reasons for merging with Abbey National was that the big banks were losing business, Barclays' experience showed that this was not necessarily a permanent problem. CA's analysis also showed that First Direct had virtually no presence in the market for new current accounts. CA believed this indicated that channel-specific new entrants were unlikely to have much effect on the position of the big four in the immediate future. The relative weakness of the other small players was further evidence of this.

### ***Mortgages***

6.96. CA said that the mortgage market was considerably more competitive than the PCA market. This was largely because of the different dynamic in terms of the position of intermediaries and the role of remortgaging, which had grown enormously over the last few years.

### ***The merger***

6.97. The merger would increase Lloyds TSB's share of the PCA market to 30 per cent and the share of the big four to about 80 per cent. This would have a potential knock-on effect on competition. The second and, possibly, more important issue was the effect that such a merger might have in terms of greater concentration in the market among the big four banks and their ability to acquire the smaller players. Although there had been a number of new entrants, there were relatively few indicators of competition. The charging mechanisms which existed within the PCA market tended to focus on interest rates paid on credit balances and charged on overdrafts. In that respect the new entrants appeared to have had no effect on the charging policies of the big four. The parallel charging of the big four had been very strong and had not been affected by the extremely differentiated charging on overdrafts and the much greater interest offered on credit balances by smaller players. The merger would therefore allow the big players even greater ability to insulate themselves against competition from the smaller entrants. This would condemn these smaller players to a niche role.

### ***Remedies***

6.98. The merger would be against the interests of competition and of the consumer and should be prohibited. CA said that it saw no behavioural remedies available to address the significant diminution of competition resulting from the merger. Changes to the switching process alone would not be sufficient to limit the negative impact on competition. The complexity and imperfection of the switching process required more significant intervention than could be provided as a remedy in a merger inquiry. The possibility of structural remedies was reduced by the contractual nature of the relationship between consumers and their banks (ie it would not be practical—or, possibly, legal—to divest customers to another financial services provider). Other possible remedies appeared to be limited disposals in the mortgage market or a restriction on branch disposals. CA thought that such action would not be appropriate to remedy the adverse effects.

### ***Response to the issues statement***

6.99. Commenting on our issues statement (see Appendix 2.1) CA said that, whilst it believed the merger would significantly reduce competition, it did not think that overall prices were likely to be raised

for all consumers. A more likely scenario was that the market would become more segmented by the major banks and that this segmentation would allow them to price discriminate more effectively. This would lead to higher prices and worse service for some consumers. CA also thought that a key effect of the merger would be a reduced rate of innovation as smaller, more dynamic firms were swallowed up by the incumbent high street banks.

6.100. In terms of price competition, CA believed that much damage had already been done to the market as a result of a long-run successful attempt by the big four banks to restrict competition and maintain high prices. This had only recently been seriously challenged, for example by Abbey National in the PCA market. The merger would ensure that the lack of price competition apparent in the market was maintained.

### *PCAs*

6.101. CA thought that the merger would weaken competition in the PCA market even further. All of the factors listed in the issues statement indicated a lack of effective competition.

6.102. CA did not believe that there had been much progress in the position of new entrants in the PCA market. Indeed, their inability to break into this market was in stark contrast to other financial service markets. Most new entrants had been reduced to niche positions and appeared unable to break out of them. Non-traditional players had not entered the market in any number. Most such entrants had aligned themselves with existing PCA providers as a route to market entry.

- *Barriers to entry*

6.103. CA referred to its earlier evidence on the new PCA market (see paragraph 6.92) which indicated that the existence of a branch network and a strong brand were important factors in consumer choice. Given the lack of switching costs incurred, CA thought that the position in this market was particularly interesting. There was no clear evidence to date that switching would increase in the near future. Indeed, CA thought that the increasing trend toward complexity in the market, through specific targeted products as a result of a customer segmentation strategy, was likely to undermine any technical moves to improve the mechanics of switching.

- *Abbey National as a constraint on the big four*

6.104. CA thought that Abbey National had not been particularly successful in injecting competition into the market, although it had tried. Its attempt (and those of others) to compete on interest rates (payments and charges) appeared to collapse as the major banks resolutely refused to change their own structures to meet the competition. However, the fact that Abbey National had not had a significant impact to date was not a reason to allow the merger to proceed. Indeed, it was an indication that the agglomeration of market power on the part of the big four had reached such a level that most other firms now found it impossible to break their stranglehold on the PCA market. Rather than foreclose the market further by allowing the merger to go ahead, the CC should allow Abbey National to seek other partners.

### *Mortgages*

6.105. CA thought that the level of competition in the mortgage market was sufficient to limit any potential negative effects on that market from this proposed merger.

### *Other personal financial services*

6.106. CA had no evidence that the merger would have significant negative effects in other financial services markets in isolation. However, it was aware that the merger would enhance an already strong position in car finance and would exclude a potentially significant player in the business account market.

## *Combined effects on Lloyds TSB*

6.107. CA thought that the merged company would be able to maintain its margins at their current excessive levels and have no incentive to compete on price for PCAs. This would leave other PCA providers increasingly unable to offer very competitive price lead deals and thus limit competition. Over time this would enable the merged company to increase its margins. It would also be able to cross-sell poor products. The ability to deter and repel newer entrants would be significantly enhanced by the merger. This was not simply a matter of scale, although size would have an effect. It was more because of the ability to segment the existing customer base and offer highly targeted products. In combination with significant market power this was likely to lead to price discrimination and the cross-subsidy of rates to attract new customers at the expense of existing customers.

## **Independent Banking Advisory Service**

6.108. Mr Eddy Weatherill, the chief executive of the Independent Banking Advisory Service (IBAS), gave evidence in writing and at the open meeting. Mr Weatherill had been involved in long-running litigation with Lloyds TSB in which he had been unsuccessful, with the exception of one part of his claim. He had not disclosed this in his main submission or at the open meeting because, he said, it was a matter of public record. Although Mr Weatherill was not able to tell us how large the membership of IBAS was, he gave us to understand that his submission was based on experience gained from eight years of analysing banking case histories and information, rather than on any specific consultation with IBAS members.

6.109. Mr Weatherill was opposed to the merger. He believed that Lloyds TSB's behavioural pattern had become well established over the last decade and that its objectives had always been for high profits from cost cutting and increased margins. Following previous mergers Lloyds TSB had reduced staffing levels to the minimum with a resulting reduced service to customers.

## ***Branch networks***

6.110. Mr Weatherill believed that initiating and maintaining any competition in the financial services market would be impossible without a branch network. It had become obvious that, while consumers required various types of banking services, branch banking remained the preferred option for the majority. This position would remain for at least the next decade, despite the apparent growth of electronic banking. The merger would remove an effective direct competitor with branch-based services.

## ***PCAs***

6.111. In Mr Weatherill's opinion the number of PCAs held by any bank determined its market strength. Therefore, the total number of PCAs held 'captive' following any proposed merger was of vital importance in assessing its effects. It was well known that customers rarely switched banks and that any bank was able to target PCA holders in order to sell other financial services and products. It was much easier for a bank to sell a product if it already knew the customer had the ability to pay and how much disposable income was available.

6.112. Mr Weatherill said that the merger would immediately reduce competition in the PCA market. The major gain to Lloyds TSB would be obtaining further PCA customers and the opportunity to sell more products to them and so provide additional profit to its shareholders.

## ***SMEs***

6.113. In Mr Weatherill's view the merger would remove a serious competitor in SME banking, which had only recently entered the field of business accounts—an area where competition was already well overdue. Allowing such a merger to take place would damage any government aims to produce an effective and believable long-term strategy for the SME market. Those with small businesses would perceive the clearance of the merger as an 'about turn' by the Government.

## ***Remedies***

6.114. Mr Weatherill did not comment on specific remedies but said that he had no confidence in any assurances of behavioural change that Lloyds TSB might give in order to achieve the merger.

## **National Association of Citizens Advice Bureaux**

6.115. The National Association of Citizens Advice Bureaux attended the open meeting. It emphasized that in considering the merger the CC should take account of the broader perspective of the public interest rather than just competition issues. In this respect it was important to consider Lloyds TSB's plans for the future of the branch network against the government's general programme of securing corporate social responsibility for tackling financial exclusion and improving financial literacy for people excluded from the mainstream market for financial services.

## **Trade unions**

### **Abbey National Staff Association**

6.116. Abbey National Staff Association (ANSA) gave written evidence and participated in the open meeting. It said that it was the only recognized independent trade union within Abbey National. ANSA noted the rapid change that was occurring in the financial services market, most of which had an impact upon competition and access to services, often with a reduction of rights, choice and customer service.

### ***The merger***

6.117. Although it was not opposed to mergers as such, ANSA believed that this merger would be against the public interest. If it took place it would clear the way for other banks that sought to consolidate their position in the market. Any future merger of a smaller bank with one of the big four banks might not be referred to the CC. This would mean, in effect, that there would never be more than four major banks in the UK.

6.118. Whilst ANSA fully recognized the need for the banking sector to be profitable, it was concerned that so little of the banks' profits had been used to benefit customers. Indeed, despite the economies of scale the big four enjoyed, their interest rates had consistently been poorer than those of new entrants. This was particularly true of Lloyds TSB. ANSA believed that a further concentration of power would only accelerate this trend.

### ***The branch network***

6.119. ANSA thought that the merger would result in large-scale closures of high street branches. There were some 600 Lloyds TSB and Abbey National branches within 400 metres of each other and it was likely that these branches would be rationalized with resulting job losses. ANSA said that Lloyds TSB had closed some 24 per cent of its branches in the last ten years. It believed that the bulk of the savings proposed as a result of the merger would not happen by growing the business or by giving better value to customers, but by stripping the assets of the company and cost cutting. This would mean even fewer branches, with fewer staff and no increase in customer benefits. ANSA noted that the drop of 30 per cent in the total number of bank and building society branches between 1988 and 1998 had already led to a number of small towns and villages having no banking facilities. A further concentration in the banking sector would exacerbate this situation.

### ***Job losses***

6.120. The merger would threaten the jobs of ANSA members, those of employees across the merged company and jobs in the smaller banks and building societies. ANSA believed that the loss of

9,000 jobs could not be achieved without compulsory redundancies. In such a large scale exercise there would inevitably be a mismatch between job losses and volunteers. Moreover, experience of previous mergers suggested that the final total for job losses could be twice the figure quoted.

6.121. ANSA said that most of the jobs that were lost following mergers were those of female staff and many were part time. In addition older workers often bore the brunt of job losses and consequently faced considerable difficulties in gaining other employment. The Chief Executive of Lloyds TSB had said that staff who were made redundant would easily find other jobs. ANSA was concerned about this statement. He had also promised that the merger would lead to £950 million in extra profit with £650 million of this figure from reduced costs, mainly job losses.

### ***Competition issues***

6.122. ANSA said that the merger would result in a substantial reduction in competition for both PCAs and mortgages. It would give Lloyds TSB market shares of over 25 per cent in PCAs and slightly less than 30 per cent in mortgages. In addition it would concentrate over 80 per cent of PCA activity in the hands of the four big banks. Lloyds TSB was already the largest holder of PCAs with 9.1 million accounts and the merger would add another 3.75 million. It would also remove a further competitor from the SME market. The big four banks already accounted for 91 per cent of the market share for SMEs, of which Lloyds TSB had 20 per cent. Abbey National was one of the few banks that could offer an alternative to the big four.

6.123. Although there had been claims of increased competition in the financial services sector, customers did not appear to have benefited. Choice had been reduced through mergers. Bigger banks did not necessarily mean bigger choices. In addition many new banks in the sector, particularly supermarket and Internet banks, were closely linked to the big four banks or were offshoots of established banks or finance companies.

### ***Customer service***

6.124. Customers were increasingly facing a poorer service in the banking market. The merger would lead to branch closures, a concentration of more accounts per branch, and more accounts per member of staff, which could only lead to poorer customer service.

### ***Social exclusion***

6.125. ANSA was also concerned about social exclusion. More power in the market would enable an enlarged bank to cherry-pick customers at the expense of the less well off. ANSA believed that access to retail financial services was an essential part of social well-being in a modern economy and that the merger would increase social exclusion.

### ***Remedies***

6.126. ANSA said that it had reservations about allowing the merger to go ahead with safeguards because of the difficulty in policing them. It also questioned whether safeguards would place the merged company at a disadvantage in the marketplace. Lloyds TSB had hinted at a degree of brand separation and ANSA asked how this could be underwritten. However, it suggested a number of safeguards that should be considered if safeguards were deemed to be feasible and practical.

### **Lloyds TSB Group Union**

6.127. Lloyds TSB Group Union (LTU) gave written evidence and participated in the open meeting. It told us that it was the independent union representing over 39,000 Lloyds TSB staff. The LTU said that consumers needed healthy, profitable banks which competed vigorously with each other rather than just managing to survive in an increasingly tough market. Despite apparently large profits, all financial

service providers were under pressure from either the markets or falling margins and some consolidation was inevitable. The LTU believed that the merger would assist this process without damaging competition or consumers' interests. It was concerned that the facts of the merger had been wrongly reported by the media.

### ***Branch closures***

6.128. The LTU said that the major banks maintained branch networks because a large proportion of customers required them and their closure would be politically sensitive. However, customers were increasingly demanding different delivery channels to suit their varying needs. Change would need to be introduced gradually and should preserve customer service, maintain reasonable levels of profitability and safeguard the interests of smaller communities and people without Internet access, including the elderly and the less privileged. Preserving branch networks that were no longer supported and became unprofitable would lead ultimately to more urgent and dramatic change and would be detrimental to consumers' interests. The LTU believed that Lloyds TSB's stated plans should be seen in this context.

6.129. The suggestion that Lloyds TSB planned the immediate closure of 600 Abbey National branches was misleading. What it had actually said was that after two years it would 'begin a programme to bring together Lloyds TSB and Abbey National branches in the more than 600 locations where they are within 0.25 miles of each other'. The LTU's experience was that Lloyds TSB was concerned about branch closures, not least because of the likely reaction from the media. The company had a policy of keeping open any branch that was the last one in a town. There was no indication that this would change. On the contrary, if the merger went ahead, Abbey National customers would also be able to use Lloyds TSB branches. Further, the LTU understood that Lloyds TSB's agency agreement with the Post Office would be extended to Abbey National's customers. This would be important to those customers in rural areas who currently had no access to banking facilities. The LTU stressed that there was a difference between closing branches and relocating them to make the best use of expensive high street premises. If the merger went ahead Abbey National customers would still have access to their accounts in the same locations (although not necessarily the same building) and its staff would work in the same communities.

6.130. The LTU said that job losses and compulsory redundancies were not synonymous. As with most large mergers, part of the rationale for the merger was to acquire economies of scale. The LTU accepted that there would be job losses. However, it said that the analogies that had been drawn with the motor and steel industries were misplaced. The forecast reductions of about 9,000 staff, to be achieved over four years, could easily be met through natural wastage, which in Lloyds TSB was about 7,000 a year across the UK. The addition of Abbey National staff would suggest an annual natural wastage of about 9,500. Therefore the merged company (with 100,000 staff) would provide more than enough natural wastage and obviate the need for compulsory redundancies.

6.131. The image portrayed by the media of Lloyds TSB implementing widespread compulsory redundancies was at odds with the company's usual approach. The LTU said that it had had some serious disagreements with Lloyds TSB over negotiating issues but job security had not been one of them. Reports in the media and to MPs regarding the jobs lost as a result of the merger between Lloyds Bank and the TSB had been misleading. The number of compulsory redundancies that had resulted had been minimal. Lloyds TSB had negotiated severance terms that attracted many volunteers and since then the unions and the company had introduced robust job security procedures that had worked to make any compulsory redundancy rare.

### ***Competition and the personal sector***

6.132. The LTU believed that the merger was in the best interests of all stakeholders including customers, shareholders and staff in both companies. The assertion that it would reduce competition was academic. On the high street, competition was fierce in almost every area of financial services business. Customers were switching their mortgages and PCAs and there was competition between traditional and new providers. In practice consumers had never had such a wide choice.

6.133. The major banks had not been able to cherry-pick the most profitable customers in the way that their niche competitors had. Under pressure from special interest groups, the media and Parliament,

the major banks including Lloyds TSB were forced to provide services that the public needed but which were relatively unprofitable, such as basic bank accounts. For example, Lloyds TSB's policy of keeping open the last branch in a town could only be guaranteed by a competitive and profitable company.

### ***SMEs***

6.134. The LTU said that with Abbey National holding a very small proportion of the total market (reported to be only 1 per cent) and offering only limited SME service, there would be no threat to competition in this market. The combined SME business of the merged company would be materially less than that of RBS/NatWest.

### **UNIFI**

6.135. UNIFI, the trade union for employees in the financial services industry, told us that it had members in both Lloyds TSB and Abbey National. It gave written evidence and participated in the open meeting. UNIFI noted, in particular, the impact mergers had on the financial services market including the reduction in choice and service as a result of branch closures and staff reductions. It was also necessary to consider the impact on the needs of the socially excluded. It believed that all proposed mergers involving the ten largest financial institutions should be automatically referred to the CC as mentioned in the Cruickshank report. UNIFI said that this merger would reduce jobs and branches, and thus reduce choice, access and service quality. It believed that, unless Lloyds TSB agreed specific guarantees for protection to employees and gave undertakings in respect of customers and local communities, the merger should be prohibited.

### ***Employees***

6.136. UNIFI said that it had a constructive relationship with Lloyds TSB and a joint agreement covering security of employment which was widely regarded as one of the most progressive in the finance sector. The agreement had worked well in handling the 16,400 job losses occurring in the bank since the merger of Lloyds Bank and TSB in 1996. However, UNIFI was concerned that the 9,000 further job losses arising from this merger would have major adverse consequences for employees, including forced redeployment, unrealistic relocation options and downgrading to lower paid jobs. The negative effect of these consequences on employees could lead to deterioration in the quality of service to customers. For these reasons UNIFI had sought to strengthen its current job security agreement with Lloyds TSB by asking it to provide a 'no compulsory redundancy' guarantee for current and newly acquired staff. Lloyds TSB had not agreed to give such an undertaking.

6.137. UNIFI said that Lloyds TSB was currently experiencing staffing difficulties that were partly the result of recent overenthusiastic cutbacks in staff numbers and increased employment in a number of its operations, for example telephone centres. The union believed that the reluctance to give the 'no compulsory redundancy' undertaking arose from Lloyds TSB's inability properly to coordinate and plan an integrated approach to change management, recruitment and resourcing. UNIFI believed that, if the merger were allowed to proceed, Lloyds TSB should be required to give an undertaking that there would be no net job losses in regions of the country defined by the Government as having special economic status. This would give some protection against the rationalization of 'back office' or customer support functions, some of which were located in economically depressed regions, for example South Wales and the North-East. In Abbey National significant numbers were employed in Bradford as well as Milton Keynes.

6.138. Although it noted the trend towards multiple branding within large financial conglomerates, UNIFI was also concerned about the possible medium- to long-term effect on the Cheltenham & Gloucester business. Its disposal or integration into the Abbey National business would, in UNIFI's view, have serious employment consequences, particularly in the Cheltenham and Gloucester areas where there were large concentrations of employment. Therefore if the merger went ahead UNIFI would like to see assurances from Lloyds TSB in connection with its longer-term plans for Cheltenham & Gloucester.

## ***Customers and branches***

6.139. UNIFI noted the finding of the Cruickshank report that in general neither personal nor SME customers were getting a fair deal from banks, and the report's conclusion that ineffective competition was to blame. UNIFI said that although there had been an alleged increase in competition in the financial services market of late, this had not benefited customers. An example of this was the average interest paid on instant access accounts. In addition some claims of increased competition and of greater consumer choice ignored the fact that in reality the supermarket and Internet banks were closely linked to the major banks. Rather than creating new banks, new technology created new avenues by which existing banks could increase market share.

6.140. UNIFI said that the merger would create a bank with market shares in the region of 30 per cent for PCAs and slightly less than 25 per cent for mortgages. It would give Lloyds TSB further concentration of PCAs when it already had the largest market share with 9.1 million accounts (almost 2 million more than the newly merged RBS/NatWest). After the merger almost 80 per cent of PCA activity would be concentrated among the big four banks. The removal of Abbey National would also remove a vibrant second-tier company.

6.141. Abbey National had in the order of 750 branches, more than 600 of which were near a Lloyds TSB branch. Customer choice would inevitably be reduced if there were closures. UNIFI noted that the total of bank and building society branches had already been reduced significantly in recent years, with a fall of 30 per cent between 1988 and 1998. Moreover the merger should be considered within the context of recent consumer dissatisfaction with banking services.

6.142. The merger would also remove a further competitor from the SME market. The big four banks together already had a 91 per cent share of the SME market, of which Lloyds TSB had 20 per cent. There was thus little competition in this sector for charges, clearing times or bank coverage. Abbey National was one of the few banks that could offer an alternative to the big four.

## **National Union of Students**

6.143. The National Union of Students (NUS) attended a hearing. It said that it had an overall membership of 3.2 million students who were members as a result of membership of their students' unions. The NUS was against the proposed merger because it would reduce the marketplace for student customers and the student movement. As a result of NUS policies on various issues such as, for example, some banks' involvement in third world debt, the NUS had decided against banking with HSBC, Barclays and Lloyds TSB. A second reason for opposing the merger was that it would add to the enormous market power of the big four who were in danger of controlling the marketplace. Third, the NUS had a contract with Abbey National with which it was entirely satisfied; the merger could well result in there being a contract that neither the NUS nor the merged bank would be able to fulfil. Generally, while the NUS accepted that banks should be able to increase their market shares, this should not happen as a result of one of the big four acquiring a smaller bank.

6.144. The NUS said that its deal with Abbey National had been launched in combination with the Internet service which the NUS had recently started. Abbey National, for its part, had worked to improve its online presence and to develop its products in the student sector. An online option was a good one for Abbey National as it did not have the resources the big four had to develop branches on campuses; it was also important for the bank to get access to an IT-literate market that might otherwise gravitate to the big four. The deal helped the NUS to launch its new web site and join in what was a highly innovative partnership. It had been very successful. A large number of accounts (some 50,000) had been opened between September and December 2000 and the NUS and Abbey National were now working on a product suitable for the further education sector.

6.145. Important though developing banking services on the Internet was, the NUS believed that the existence of a branch network was vital. Monitoring what went on in a PCA, for example, was a good enough function for the telephone or the Internet to handle, but more complex operations were best done face to face in a branch—for example, discussing what ISAs to choose, pension arrangements, increasing the size of personal loans and so on.

6.146. The major banks tended to cherry-pick in the way they handled students and their PCAs, which the NUS found to be objectionable. Students on certain courses, for example accountancy and medicine, were given more generous startup benefits than those studying other types of subject. And those at established universities such as Leeds would get better deals than students at some of the former polytechnics.

6.147. The NUS considered that students as a group were not a very profitable short-term market for the banks. However, they were taken on willingly by the banks because of the earnings potential they represented in the medium to long term. On the subject of switching, the NUS did not think that there was a particular student feature of this aspect of the market. Students were, however, more mobile than other groups in that they were likely to be less encumbered with standing orders and direct debits and so were more prepared to switch between providers.

6.148. The NUS did not think that the big four competed aggressively among themselves. They fought hard for new student PCA accounts but showed no signs of trying to attack each other's customer bases.

6.149. Finally, on whether or not bank brands and marketing had an impact on students, the NUS thought that they did not or at any rate, if they did, the effect was less than in other sectors. It was possible that students would become more responsive to branded products endorsed by the NUS, following the NUS/Abbey National deal, but this would take time to occur.

## **Trade associations and other bodies**

### **British Retail Consortium**

6.150. The British Retail Consortium said that it would be concerned if the merger significantly increased Lloyds TSB's share of the market for banking services to SMEs. It found it difficult to form a final view as to whether the merger would be against the public interest without knowing the outcome of the CC's current monopoly inquiry into the supply of banking services to SMEs. Indeed, it believed that improving services to SMEs was of such importance that a decision on the merger should be delayed until the CC's conclusions on the monopoly inquiry were published. It believed that part of any operational savings resulting from the merger should be utilized to reduce charges to Lloyds TSB SME customers.

### **British Shops and Stores Association Limited**

6.151. The British Shops and Stores Association Limited represents 3,300 retail businesses in the UK, together accounting for about 10,000 outlets in the non-food sector. It told us that it reflected the views of small and medium-sized retailers and, as a member of the British Retail Consortium, fully endorsed the views expressed by that organization.

### **The National Federation of Retail Newsagents**

6.152. The National Federation of Retail Newsagents said that it was opposed to the merger on the grounds that it would eliminate one provider of banking services and strengthen the position of another. This would further affect the position of the SME sector, which did not have the bargaining power of the big retailers or companies.

### **Radio, Electrical and Television Retailers' Association Ltd**

6.153. Radio, Electrical and Television Retailers' Association Ltd (RETRA) said that the merger would reduce competition in what was already a restricted market. It would lead inevitably to further closures of local bank branches, and thus the loss of the relationship with local managers who had some

understanding and empathy with its members' businesses. Further concentration of SME services into the hands of a few, often remote, decision-makers was against the public interest. RETRA was therefore opposed to the merger.

## **Academic**

### **Professor David Llewellyn**

6.154. Professor Llewellyn, Professor of Money and Banking at Loughborough University, spoke at the open meeting. He said that it was important to look at the broader context of what was happening in the retail financial services market and, above all, at how the market was evolving. His fear was that public policy judgements might be based on a snapshot at a particular point in time, without recognizing that the key characteristic aspect of this industry was one of very substantial change.

6.155. The first key aspect, particularly of retail banking, was not so much the degree of competition but the degree of contestability in the market. Many current changes and pressures were increasing contestability. Where a market was more contestable, as this one was, the power of competition was not measured by the number of competitors, and the degree of concentration in that industry did not necessarily indicate the ability to adopt anti-competitive behaviour against the consumer interest. The ability of new firms to come in, and also to get out at relatively low cost, was as important an issue as the number of players at any one time in the market. Several factors had been increasing the contestability of the market: for example the development of information technology had lowered entry barriers; the supply of information had been increasing, so the cost of information was falling for potential new entrants into the market; the development of credit-scoring techniques had lowered entry barriers, making it easier for newcomers to analyse information and risks; the ability of firms to outsource processing had facilitated entry; and new delivery channels had removed the necessity of a branch network.

6.156. The second key aspect was that the market environment for retail banking was changing very rapidly. For example, the production of banking services and the delivery of and access to banking services were undergoing substantial change. This change had led to new organizational structures (for example, through outsourcing) in which new, relatively small, firms had incentives to come into the market.

6.157. The third key aspect was that a combination of factors was changing the underlying economics of retail banking. The problem from a public policy point of view, therefore, was that the CC was shooting at a moving target. A judgement needed to be made as to whether we were going to shoot at this target as it currently was or at a target that might emerge in X years time. It was a difficult judgement to make.

6.158. However, Professor Llewellyn said that we also had to recognize that the degree of competition and the degree of contestability were very different as between different subsets of the retail banking market. There was no such thing as 'the retail banking market'. It needed to be divided between different customer groups and between different products and services. Diagrammatically, one could imagine a matrix of customer groups on a horizontal axis and of products on a vertical axis. There was then a series of cells within that matrix, and while there were varying degrees of substitutability, each one of the cells could be identified as a separate market. The degree of contestability and competition in those cells could vary quite substantially.

6.159. Professor Llewellyn said that, as entry barriers had been declining, competition was developing, not only from within the traditional industry, but largely from outside. Such external competition was often much more powerful than internally-generated competition, simply because the economics of new players were different, their strategies were different and, above all, their cost structures were fundamentally different from those of the incumbents. The recent new entrants in the financial services sector were highly focused in the product ranges they chose. Virtually all offered services in very limited areas, and it was in those areas that the degree of contestability was high. The existing banks were used to cross-subsidizing other parts of their business from the more profitable areas. New players, however, were leaving the subsidized parts of the retail banking business to the existing players. This would present a challenge to the established banks.

6.160. With the development of technology and outsourcing, new firms could now enter this market without doing everything themselves. They simply subcontracted those parts that they were not efficient at and that substantially reduced entry barriers. It meant that the benefits of economies of scale were obtainable by firms that were still small. Consequently, scale was becoming less significant. This was rather against the conventional wisdom. And if scale was less significant, then there was less need for mergers because, in some business areas, the benefits of scale could be obtained in other ways. But it was also the case that, if scale was a less significant factor than hitherto, public policy concern about mergers should correspondingly be less because newcomers could still enter the market and secure the benefits of economies of scale in other ways, for example outsourcing.

6.161. Professor Llewellyn also said that it was important not to underestimate how the Internet was changing the fundamental economics of the banking industry: distance was becoming meaningless; consumer search costs were being reduced; and price transparency was being increased.

6.162. Professor Llewellyn added that, whilst the CC might want to look at brand image as a potential barrier to entry, in his judgement this barrier could be exaggerated. First, the consumer image of who could credibly offer retail financial services had changed quite radically over the past few years. Five years ago having a major savings account at a grocery chain subsidiary would have seemed pretty odd, but now that was entirely acceptable. So it was not certain that the consumer would automatically gravitate towards the traditional player. Second, there was the example of first-e, a new organization which within a relatively few months had proved able to acquire substantial balances. So there was a question mark over how necessary it was to have a known brand. In any case, as entry barriers had declined some of the new entrants (for example, supermarkets) already had strong brands developed in other businesses.

6.163. Looking at switching in the PCA market, Professor Llewellyn said that it was accepted that switching of accounts was comparatively low. Two reasons were normally given. One was that the consumer was broadly happy with the service he or she was getting, so the incentive to move was not there. The other was that the consumer was not really satisfied, but the transaction costs of switching were too high. There was, however, a third possibility which was perhaps more realistic than either: that was the rather perverse pricing in this market, in the sense that PCAs were seemingly free so there was no price advantage in switching. Of course, in reality there was no free banking. People simply paid for banking in a rather inefficient way through relatively low rates of interest on positive balances. If we were to move to a regime where the consumer paid the economic cost of transactions as and when made but received a market rate of interest on any positive balance in the account, then Professor Llewellyn thought that there would be more scope for competition in PCAs. At the moment, there was no observable price of PCAs and this reduced the number of ways in which brands could compete. Perhaps ironically, the consumer could actually benefit by being charged for PCA services as and when used.

## **Advertising agencies**

### **Delaney Lund Knox Warren**

#### ***Brand dynamics in the financial services market***

6.164. Mr Greg Delaney, Chairman of the advertising agency Delaney Lund Knox Warren (DLKW), and Mr Richard Warren, DLKW's director of strategy, gave written and oral evidence. Mr Delaney said that his agency currently worked as brand adviser to Halifax. In the financial services market over 40 brands were advertised, with an annual expenditure of over £700 million. Despite or perhaps because of this excess of brand messages, consumers were often unable to differentiate between them. People were not very interested in financial services. There was therefore less perceived choice in this market than in other sectors which had fewer competitors and more clearly-defined differences. Choices often depended on location or family tradition rather than real brand differentiation. This was a contrast with other areas where people perceived differences, for example between Tesco and Sainsbury.

6.165. Other critical factors in the financial services market were service and price. Service was particularly important in PCAs, where there was more interaction and more potential for disappointment than with savings or mortgage transactions. Price offered the opportunity for product and brand differentiation, and had been used by new entrants like Egg to try to tempt new customers out of their financial

inertia. As in other markets, the ideal differentiated brand positioning was one of ‘perceived good value’, where consumers were encouraged to compare the brand favourably with others on a combination of service and price criteria.

### ***Bank brands***

6.166. Until recently the big four bank brands had been seen as virtually indistinguishable from each other. There were now signs that these banks were attempting to create and communicate some brand differences, usually by focusing on service. A number of brands other than those of the major banks were registering positively with consumers, as were brands which used only the Internet, or a combination of telephone and Internet, offering more distinctive if rather niche appeal choices.

### ***The Abbey National brand***

6.167. Ten years ago, after Abbey National had demutualized, it had been seen as both innovative and modern, with some of the more ‘unincorporate’ values associated with the mutuals. Since then its brand differential had been eroded. There had been few distinctive product initiatives and Abbey National had tended to follow either the clearing banks or Halifax in its current account and mortgage offerings. As a result of this lack of differentiation, and of Abbey National’s involvement in the less forgiving arena of PCAs, consumers now saw little difference between it and the major banks. Without a distinct brand difference, attachment to the brand defaulted to convenient locations, something which many customers found more important than the brand itself. So whilst many customers might object if their local convenient Abbey National branch was no longer there, they would not necessarily feel the lack of that brand. Potentially, the bank could still change but its record in the past ten years did not augur well. The true test of a powerful brand was that people would go out of their way to experience it. Few of the standard brands on offer in the financial services market commanded that kind of loyalty.

6.168. Mr Warren added that brand strength was created primarily by advertising but was also achieved through product innovation and differentiation, such as Halifax’s 4 per cent interest PCA. Halifax had had much more success in attracting people to its PCAs by offering 4 per cent interest than it would ever have done if it had simply tried to create some kind of differentiation based on service and brand. The big four, on the other hand, had chosen to differentiate on the basis of service rather than value and their advertising spend was heavily skewed towards customer retention. This type of advertising spend, therefore, was akin to a barrier to entry.

6.169. Mr Warren added that it did not make much sense for entrants to try to differentiate on the basis of intangibles because doing so was such a slow process. In every other sector one would achieve differentiation rapidly with tangible and substantial evidence, but this did not happen in banking. Halifax’s new current account was succeeding because it offered tangible value in an area where value had not traditionally been a differentiating factor. The overall goal should be for a bank to offer both low prices and good service, as people did not solely want low prices.

6.170. Looking at market shares, Mr Delaney said that he believed that the size of a bank was a crucial factor. There was a distinct correlation between the size of the players and their share of new customers. Size was certainly significant as far as considerations such as location or family recommendation were concerned for a new customer deciding which bank to choose. The sheer scale of the big four meant that they were going to get more customers than the others.

6.171. Another area of interest was switching. There was enormous inertia. This was due to a number of causes including, Mr Warren suggested, the common view that all banks were similar and the fear of difficulties over changing standing orders and direct debits. Nevertheless, Mr Delaney added, the trend was towards more switching as people gradually became more financially aware and involved in their banking arrangements. The mortgage market was a leader here—a large number of people now switched mortgage providers. There was a similar story with credit cards—competition between credit card providers was now very strong, whereas with PCAs among the big four it was not. There was no reason why that should not change, however.

## **Euro RSCG Wnek Gosper**

6.172. Mr Flaherty, the strategic planning director at the advertising agency Euro RSCG Wnek Gosper, attended a hearing. He said that his company worked for Abbey National in advertising and branding. He said that financial services brands were different from typical fast moving consumer goods brands in that it was not possible for customers to try them in the same way. Because banks were largely service brands it was difficult to experience the service without being customers of the organization in question. But much of the differentiation between brands lay in the service experience, because most banking products were somewhat intangible.

6.173. Barriers to entry were significant. Whilst one might assume that a demutualized building society with a long history of trust and credentials in the mortgage business might have no difficulty moving into mainstream banking, the reality was different. It was hard for such organizations to win the necessary credibility with customers, especially those conditioned by the long heritage and reputation of the big four.

6.174. It was difficult for people to decide whether or not the PCAs they held represented value for money. Comparisons were difficult and there was a suspicion that it was in the interests of the big four, who had most of the PCAs, to make the task as difficult as possible. And this was compounded by the levels of inertia among customers. On inertia, the big four claimed high levels of satisfaction as the reason but independent sources, for example *Which?*, told a different story. If one looked at the 'best buy' tables, the big four rarely featured in the lead positions on value for money criteria, unlike Abbey National. Abbey National was differentiated from other banks in having an image of fairness, unstuffiness, value for money and friendliness.

6.175. On innovation in PCAs, the newer entrants had a much better record than the big four. Abbey National's research showed that, out of nineteen significant innovations in the PCA sector since 1990, only three had come from the big four banks. Such innovation as there was among these banks tended to be reactionary, that is, when they felt challenged or under threat from outsiders.

6.176. Mr Flaherty accepted that obtaining a critical mass of accounts was an important feature in the effort to persuade people to switch into a bank. Abbey National had had the highest share of PCA switchers in the last two years and was more successful in this area than other banks, including Halifax. One had to accept that people were nervous about switching: it meant abandoning a relationship that had often been held for a long time; there were possible difficulties over credit ratings; and there were significant emotional barriers. Many of the PCAs opened in newer banks offering higher rates of interest were not real switches of primary accounts but were secondary accounts that could be withdrawn easily if interest rates fell. The idea, therefore, that there was now a great deal of competition for PCAs was false.

6.177. Mr Flaherty said that it had taken substantial banks like Abbey National and Halifax a long time to build up the necessary credibility as suppliers of PCAs to the point at which they were regarded as potential and effective PCA competitors to the big four. Even so, many people were unaware that these demutualized banks offered full banking services. The marketing costs associated with creating this awareness amounted to a substantial barrier to entry and came on top of that represented by inertia over switching.

6.178. Finally, Mr Flaherty said that HBOS, the prospective new entity formed from the Halifax/BoS merger, might well have a significant effect, albeit primarily in the business banking area, as a challenge to the position of the big four.

## **Saatchi & Saatchi**

6.179. Ms Ingram, the Executive Chairman of Saatchi & Saatchi, which handled Lloyds TSB's account, attended a hearing and gave written evidence. She said that she believed that brand strength in the banking industry derived partly from advertising and partly from trust in the bank in question. On the latter, organizations like Tesco, for example, were able to build a financial offering very quickly because of the enormous trust and brand recognition they could command. A strong brand would also have no barriers to entry to the financial services sector. One of the key ways for any firm to build trust was to offer a high level of service; this also engendered consumer loyalty.

6.180. Also important to brand strength was producing the products that people wanted. If these were not delivered, consumers would disappear and other players would come in to the market, as First Direct had done. She disagreed, therefore, with the claim by Mr Delaney that there was low interest in banking matters. Public interest was high and successful banks had huge consumer recognition and trust. Lloyds TSB was third, for example, after Tesco and Marks & Spencer in this respect. As well as offering the right products, banks became strong on the basis of the value and service levels they created and the relationships they built up with customers. Levels of dissatisfaction with the established banks were low. This was due to the banks taking good care to ensure a high degree of customer satisfaction.

6.181. Differentiation was very important in branding and Ms Ingram thought that the major banks succeeded in establishing this differentiation. Lloyds TSB certainly did so and, importantly, with its staff as well as its customers—engendering a motivated workforce. Lloyds TSB’s effort focused on customers and their needs and on giving them the message that the bank was there to serve them. Halifax was the other major bank seen as being highly customer focused.

6.182. In Ms Ingram’s view, it would be quite wrong to say that the big four did not really compete with each other on PCAs. As seen from an advertiser’s standpoint, these banks competed very strongly with each other. Nor was it true, certainly as far as banks like Halifax were concerned, that people were unaware that the demutualized building societies offered PCAs and could provide an alternative to the big four. People no longer found it very difficult to switch; the research showed this. It also showed, however, that most people were content with their current PCA providers and did not want to switch.

6.183. Asked about the effect on the other banks of the prospective merger between Halifax and BoS, Ms Ingram considered that it would result in them refining their strategies in order to improve their competitiveness. There was no doubt that the new merged bank would be a major force in the market and a very strong one.

6.184. Ms Ingram said that research evidence showed that:

- Intangibles such as convenient location, reputation/image and recommendations were more important than tangible attributes, such as price. For this reason Lloyds TSB actively competed on service attributes and its success showed in its ratings.
- 44 per cent of Lloyds TSB’s advertising was, nevertheless, based on value.
- On switching, a recent omnibus survey by ICM found that 90 per cent of people switching had considered it either very easy or quite easy to do.
- Abbey National was a largely undifferentiated player. Tracking surveys showed it to be behind others in key features such as trustworthiness, competitive pricing and innovation.
- Among Abbey National, Halifax and Nationwide, Abbey National had been the least successful in obtaining PCA customers from the big four. It was also an under-achiever in terms of customer relations.

## **Government departments/public bodies**

### **The Post Office**

6.185. The Post Office said that it supported the proposed merger and felt that it would have a positive impact on the public interest.

6.186. Through its wholly-owned subsidiary, Post Office Counters Ltd, the Post Office provided a service to Abbey National by allowing its Internet banking and business customers a deposit and withdrawal service at all post office branches. A similar arrangement was held with Lloyds TSB PCA holders. Lloyds TSB had stated that it would extend these facilities to Abbey National PCA holders if the merger proceeded.

6.187. The Post Office said that it welcomed the increase in transactions which would result from the merger and believed that customers would benefit from access to a service at so many conveniently situated outlets. In addition the increase in transactions at post office outlets would help to sustain the national network of post office branches, particularly in those rural and urban sites where neither Abbey National nor Lloyds TSB had branches.

## **The National Assembly for Wales**

6.188. The National Assembly for Wales said that its concern was that the merger could lead to closures in the more rural areas of Wales, although it understood that there was no duplication in these areas and that closures could occur irrespective of a merger. The Assembly was concerned that the merger could diminish consumer choice, particularly in small towns where there were few bank branches. Even if branches were not closed in those areas, consumers would probably have fewer financial products available to them. The Assembly also noted that Abbey National, through its First National home loans and mortgages subsidiary, had a small 'back office' operation at Caerphilly in South-East Wales. There was a possible risk to this operation. It hoped that Lloyds TSB would offer any staff who might be displaced alternative employment within its call centre operations across South Wales.

## **Scottish Executive**

6.189. The Scottish Executive said that it was aware that the CC's remit in this inquiry was to look at all aspects of the merger's effect on the public interest, especially the impact of competition in the supply of banking and financial services. It requested that detailed information on competition concerns be sourced and considered in that context.

## **Supermarkets**

### **Somerfield plc**

6.190. Somerfield expressed concern at the potential impact of the merger on the competitiveness of the syndicated loan market and on the number of domestic banks potentially able to provide overdraft facilities.

### **Tesco plc**

6.191. Tesco expressed concern that the further consolidation of the industry resulting from the merger might affect progress that had been made in particular financial services, for example the reduction there had been in charges for ATM transactions. It would wish to see this concern addressed by an appropriate undertaking from Lloyds TSB.

## **Others**

6.192. We asked a number of supermarkets whether they had plans to provide PCAs and, if not, why they had decided not to do so. A leading supermarket group told us that one of the reasons why it did not offer a PCA was because of the marginal profit, at best, that a market leading PCA would generate. The other reasons it gave were the need for more time to be seen as an established player in the financial services market; the operational complexity of opening and offering PCAs; and the fact that switching remained complex, time consuming and error-prone for customers. Another leading supermarket group said that it had chosen not to introduce PCAs because the costs and service requirements were very high and history suggested that only a very small proportion of customers would change PCA provider. It recognized that this put it at a disadvantage for the cross-selling of other products, which was much easier if the customer had a PCA with the supplier concerned, but said that it would continue to look for other methods of attracting customers to its product range.

## **MPs**

### **Dr Rudi Vis MP**

6.193. Dr Vis, MP for Finchley and Golders Green, said that he was concerned about the current lack of competition in the SME market, and that the merger would result in a concentration of current accounts being held by one financial provider. He also expressed the view, which he said was shared by professional bodies that regulated this sector, that where organizations became too powerful they, rather than the professional bodies, set the standards for ethics.

### **Mrs Louise Ellman MP**

6.194. Mrs Ellman, MP for Liverpool Riverside, expressed concern about the effect the merger would have on employees, particularly as a result of the loss of 9,000 Abbey National jobs, in terms of redeployment for those made redundant and the increased workload of those who remained. Noting the comments in the Cruickshank report about further concentration, Mrs Ellman said that by removing a second-tier company from the personal and SME markets the merger would reduce competition in those markets. If the merger resulted in the closure of 600 branches it would reduce access to services. In addition the merger would set a precedent for the major banks to take over other second-tier companies and further concentrate the market. Mrs Ellman believed that, before the merger was allowed to proceed, it should be clearly shown to be in the interests of employees, customers, communities and shareholders.

### **Mr Bill Etherington MP**

6.195. Mr Etherington, MP for Sunderland North, said that he was opposed to the merger because of the closure of branches that would inevitably follow. There would also be a reduction in the workforce and a loss of competition and choice.

### **Sir Teddy Taylor MP**

6.196. Sir Teddy Taylor, MP for Rochford and Southend East, said that his constituents were concerned that the merger would lead to the loss of some of the currently available financial facilities, together with jobs and branches. He noted that banks and building societies, although providing a public service, had no real obligation to maintain unprofitable offices unless, of course, they were provided with government assistance to do so. Sir Teddy was concerned about the number of recent bank mergers and resulting branch closures which, he said, impacted on local confidence. However, with so many large competitors he could not see how the merger could really reduce competition; if anything he felt that competition might become fiercer as a result.

### **Mr Brian White MP**

6.197. Mr White, MP for Milton Keynes, who had previously been an Abbey National employee, said that the merger would result in a large number of job losses in the Milton Keynes area, where Abbey National was the largest private employer. It would also affect other high-tech businesses which had been established around the existence of a well-known local company.

6.198. Mr White was concerned that the merger would lead to branch closures. This, added to the growth in ATMs and the competition for branch networks, would disadvantage consumers. Although Abbey National and Cheltenham & Gloucester occupied slightly different areas of the market, a combination of the two would give the larger mortgage lenders even greater power to set interest rates and reduce competition. Mr White said that from his previous experience he knew that Abbey National's decisions could influence other financial organizations. In addition, a distinct and perceivable difference still existed between traditional high street banks and former building societies in their approach to the mortgage market. The merger would lead to mortgages becoming just another financial services product. This had social implications as well as raising competition issues.

6.199. Mr White's final area of concern was the effect the merger would have on Internet banking. He believed that the combination of the cahoot and Lloyds TSB programmes would create barriers to entry in this sector, especially to new market entrants.

## Others

6.200. A number of MPs' letters to DTI ministers, dating from before the reference, were copied to the CC. In the main these dealt with constituents' concerns that the merger should be referred to the CC because it would lead to loss of consumer choice and significant job losses.

## Individuals

6.201. We received representations (including oral representations made at the open meeting) from 55 members of the public, 42 of whom were against the merger and 13 of whom supported it. The following main points were made.

### *Perceptions of Lloyds TSB*

- (a) Lloyds TSB provided satisfactory, commercially-orientated banking services to its customers.
- (b) Lloyds TSB was not performing as well as the other major banks. It needed the synergies it could obtain by acquiring Abbey National, in order to satisfy fund managers.
- (c) Customers had switched to Abbey National because of poor service from Lloyds TSB.
- (d) Lloyds TSB was buying Abbey National in order to reduce the competition.
- (e) Lloyds TSB staff were poorly trained and lacked product knowledge. There was no effective leadership across the diverse units.
- (f) Lloyds TSB had no accountability to customers.
- (g) Lloyds TSB directors were the people most likely to benefit from the merger.
- (h) Lloyds TSB's previous takeovers were seen as being unsuccessful in integrating all sectors of the merged entity. The organizations it had taken over had deteriorated subsequently.
- (i) As a result of the merger, Lloyds TSB would be able to strengthen its position in overseas markets as well as domestic markets.

### *Perceptions of Abbey National*

- (a) Abbey National was innovative.
- (b) If the merger went ahead, Abbey National would lose its flexibility.
- (c) Abbey National offered excellent customer service.
- (d) Abbey National's services operated with simple, transparent efficiency.
- (e) A merger between BoS and Abbey National would be preferable to this merger.
- (f) Abbey National had weak top management, which would benefit from Lloyds TSB's expertise.

### *Effects of merger on consumers*

- (a) As an organization became bigger, service invariably suffered.
- (b) The merger was seen to be against the public interest, and would further exclude the poorer members of society.
- (c) Consumers would have restricted choice with regard to the type of financial products offered.
- (d) A merger would cause a further loss of branches in rural areas. Northern Ireland would lose a major competitor completely.
- (e) The economic attractions of the merger, in the short term, were outweighed by the fact that customer service would degenerate.

### *Market issues*

- (a) There was scope for consolidation in the financial sector, which would help UK banks to compete better in the worldwide financial markets.
- (b) The new high-tech entrants to the market were not strong enough to be real competitors. In addition many of them were backed by the major banks and therefore not really new entrants.
- (c) Confidence in the banking system had been built up over time, and as a result the perceived importance of the major brands could not be overestimated.
- (d) The merger would result in job losses in areas where Abbey National was a major employer, for example Milton Keynes, West Yorkshire, Edinburgh, Glasgow, London and Belfast.
- (e) The number of branch closures would increase.
- (f) There would be a loss of competition in the SME market.
- (g) A competitive banking market was paramount to fostering a healthy national economy. The merger would be anti-competitive.
- (h) In addition to gaining strong shares in unsecured lending and credit card markets, the merged company would gain market leadership in many secondary products.
- (i) The merger would allow the new group to erect barriers to entry into the market.

### **An Abbey National employee**

6.202. An Abbey National employee made the following points:

- (a) ANSA was not representative of all members of staff. It had not held a ballot to see what staff opinion was of the proposed merger and possible redundancies.
- (b) Many staff welcomed the merger and most would be happy to take voluntary redundancy. Those who wished to remain employed would be happier working for Lloyds TSB as they had no confidence in the current Abbey National management.
- (c) The merger would benefit customers and shareholders because the service provided, and subsequent returns on investments, could be greatly improved with a more experienced management team.
- (d) Customers would not suffer from any branch closure as in virtually all locations where there was an Abbey National branch there was also a Lloyds TSB branch.

- (e) Abbey National had already embarked on a long-term branch closure plan and had closed a number of branches within the last year. Customers had been primed and made ready for this by the introduction of more ATMs, e-commerce and telephone banking, all of which were offered by Lloyds TSB.
- (f) Abbey National had no significant role in the SME banking market. Its business bank account was really a savings account with a cash card and cheque book. The merger would give the opportunity to expand the SME bank account.
- (g) The PCAs held by Abbey National included accounts which offered no overdraft, cheque book or cheque card facilities. The only banking facility offered was the payment of standing orders and direct debits. To ensure that the accounts were held only by certain customers they required a minimum opening balance and monthly deposit. This was contrary to the Government's desire for banking facilities to be made available for all. Whatever Lloyds TSB's requirements for opening bank accounts were, they could not be any more obstructive to the poorer members of society.

### **A second Abbey National employee**

6.203. A second Abbey National employee and shareholder said that ANSA's opposition to the merger was not generally supported by its members. In a similar way the Abbey National board had rejected the merger without full consultation with the actual owners of the business, the shareholders. Abbey National needed a change of leadership and the merger would facilitate this. Customers had so many ways of transacting business with so many different providers it was difficult to see how competition would be reduced. The level of transactions in branches had been reducing and banks aimed to move customers from branches to other channels. The employee fully supported the merger and considered that it would be beneficial in both the short and long term for staff and customers.

### **Another Abbey National employee**

6.204. A third employee said that Abbey National had been 'sold down the river' by its management. The majority of staff were in favour of the merger.

## **Others**

### **Agre Books**

6.205. Agre Books, a small book publishing business, said that it had moved its business account from Lloyds TSB to Abbey National because Abbey National gave better terms. The level of bank charges blighted some transactions by small enterprises, for example single orders. Agre Books was against the proposed merger believing that the big four banks should not be allowed to consolidate their position further and that it was designed purely to eliminate socially valuable competition.

### **Mr David Miles**

6.206. Mr Miles, an employee of Lloyds TSB, said that he had previously worked for Abbey National. In 1999 it had introduced a target to reduce counter transactions by 75 per cent over two years. At the same time there had been a large reduction in branch staff numbers. He said that there was a widely-held belief among Abbey National staff that the company was using longer queues in branches, resulting from reduced staff numbers, to encourage customers to switch to other banking methods such as cash machines and telephone banking. Abbey National had also introduced a number of counter charges (for example for bill payments) for the same reason. Although it was reasonable to offer alter-

native methods of banking to customers with different needs, many Abbey National staff had felt that the company was forcing these alternatives on to customers.

6.207. Mr Miles said that Lloyds TSB had offered him career progression and other benefits that were not available at Abbey National. He supported the merger because it would enhance career opportunities for staff within both organizations and be beneficial to customers.

## **Mr David Rhodes**

6.208. Mr Rhodes, Senior Vice President of the Boston Consulting Group, spoke at the open meeting and said that Boston Consulting Group was a leading global firm of management consultants working for financial institutions all over the world, for many leading UK institutions such as Lloyds TSB and for many non-traditional competitors to the banks.

### ***Forces of change***

6.209. Mr Rhodes said that four broad and interrelated factors drove the significant change we were witnessing in financial services. First, consumers were becoming more demanding over service and value—greater quality, more transparency, improved convenience. Second, advances in technology were opening up new distribution and service possibilities and allowed companies to compete selectively in those market segments where they saw the highest returns. Where once banks did everything, today all sorts of specialists competed in specific areas where they had a distinct competitive advantage. MBNA and Capital One, for example, were product specialists with unique credit card capabilities. Tesco had a powerful retail franchise but was now a serious competitor in retail financial services: it provided the brand and the customer base, and then orchestrated third party providers who did everything else.

6.210. Third, there were enormous changes in the way financial services were distributed. Branches and sales forces were declining in importance. The past decade had seen the advance of the telephone. In the current decade we would see an explosion in use of the Internet, digital television and mobile devices. The absence of a branch network was no longer an impediment to acquiring and serving customers. Fourth, new entrants exploiting these new technologies and changes in consumer behaviour had transformed the competitive landscape. These new entrants ranged from insurers and former building societies invading the banks' traditional turf to unlikely players such as utilities and airlines. They were also cherry-picking many of the most important and attractive customers.

### ***Impact of change on banking competition***

6.211. The impact of all of this was that banking competition had increased significantly. Margins were declining, branches were losing out to direct sales and the banks were steadily losing market share, particularly among the most profitable, affluent customers. Average margins on deposits had halved over the last few years. New entrants, such as Egg and the supermarkets, unencumbered by expensive branch networks, had introduced low-cost, high-interest direct savings accounts. The share of the major banks in these had dropped to 30 per cent. The story was no different in unsecured personal credit. In credit cards competition was even more intense. Aggressive US card providers such as Capital One, and new British entrants such as Egg, accounted for over half all new cards issued. Net interest margins in this market had dropped by one-third over the last seven years. Competition in mortgages had also increased. Consumers had switched from branch purchase to independent brokers. Brokers now sold 55 per cent of all mortgages. Remortgaging had increased dramatically. More than one-quarter of all new mortgages were remortgages, striking evidence of consumer ability and willingness to shop around for better deals. Independent brokers also continued to dominate the life insurance, pensions and investment markets.

6.212. PCAs were no longer a sure route to cross-sales and customer relationships. They provided banks with valuable customer information, but the combination of greater customer sophistication and decreasing branch use had reduced the value of the PCA as a sales platform. Mr Rhodes thought it perverse to view retail financial services competition as centred on the banks and on PCAs. Overall, financial services providers managed over 200 million customer relationships. This suggested that the

average consumer had a relationship with around four providers, all of which were trying to grow 'share of wallet'. It was not a surprise, therefore, that the banks found it difficult to sell more than about two products per customer.

### *The future*

6.213. Looking at what the future might hold in store, Mr Rhodes said that the nature of competitive advantage was shifting. Incumbency and size used to be enough but this was no longer the case. Increasingly suppliers needed to be competitive in each individual product and each distribution channel. Of course there was still advantage to owning a customer base in a large branch network, but relying on that alone would see an inevitable erosion of the franchise. The cost of entry into almost all product categories was low and getting lower. New entrants gaining share in individual product categories were finding that they did not need a PCA offering to do so.

6.214. The incumbent banks had the disadvantage that it was expensive to operate the multichannel offer demanded by bank customers. A telephone transaction cost only a third as much as a branch transaction. Internet transactions cost even less. This gave new competitors an advantage. Mr Rhodes said that banks which did not compete effectively ran the risk of being left with just the PCA, which was expensive to operate and of decreasing relationship value. Far from being a consolidated industry, the financial services markets were becoming more fragmented.

6.215. Banks would need to consider pricing differentially by channel and service, charging for branch access and current account usage, and thus recovering the high costs of providing these services in order to compete effectively with new entrants in the other product areas who had none of the infrastructure costs associated with PCAs and branches.

6.216. Mr Rhodes concluded by saying that in branch banking, cost efficiency required scale. The implications were clear: the banking industry overall needed to drive down its collective costs, otherwise individual institutions would be unable to sustain the increasing burden of investing in new systems and new channels, while continuing to retain the branch coverage everyone wanted. Further consolidation would permit the banking system to reduce its costs even more, allowing the remaining banks to provide a more cost-effective service. The competitive environment today suggested that a good part of such cost reduction would necessarily be passed on to the consumer.

D P B KINGSMILL (*Chairman*)

G H HADLEY

D J JENKINS

D PARKER

R FOSTER (*Secretary*)

12 June 2001