

Developments in retail banking

Banking proves hard sell for supermarkets

September 2007: It is now more than 10 years since Tesco and Sainsbury's started offering financial services. Yet despite their strengths in branding and customer service, the supermarkets' banking ventures have made only a limited impact.

Given their strong brands and customer service expertise, retailers have long been seen as a threat to retail banks. But are financial services really a good fit with mass-marketing retailing or are the differences between the two sectors under-estimated?

The UK provides a valuable case study. It is now more than 10 years since Tesco, the UK's largest supermarket chain, sent shivers through UK banks by launching 'Clubcard Plus', a card-based savings account. Sainsbury's quickly followed with the launch of Sainsbury's Bank.

Marks & Spencer (M&S), the iconic own-brand clothing, food and household goods retailer, had already been offering financial services to its UK customers since the late 1980s.

After more than a decade offering financial services, what has been the retailers' impact? Have they shaken-up the market and taken customers away from the established banks? In fact, new research (on which this bulletin is based) concludes that their impact has been more limited than many (including, it should be admitted, the authors of the research report) first anticipated.

Overview

In terms of size, the retailers' financial services arms are now substantial businesses. Each has several million customers and loan / deposit portfolios of several billion pounds.

Financially, two of the three retailer banks have proved successful. Tesco Personal Finance (TPF) is now paying its shareholders substantial dividends (though profits have been flat during the last two years). Marks & Spencer sold its financial services business (M&S Money) to HSBC in 2004 at a substantial premium to net assets. In contrast however, Sainsbury's Bank has struggled, reporting an underlying operating loss of £10 million in 2005/06 and little more than break even in 2006/07.

However, the impact of the retailers on UK financial services has not been transformational. Their banking

arms remain small compared to both the major banks and insurance companies and to their own core retail businesses.

Looking at their track record in financial services, two characteristics in particular stand out.

Selective offers

First, the retailers have been highly selective in the financial services offered. Indeed, the retailers have conspicuously avoided what are arguably the most important financial services used by most of their customers. No retailer is present in the current account market or currently offering residential mortgages.

Though it made a pioneering move into mass-market unit trusts (mutual funds), M&S largely focused its financial services activities on unsecured personal loans. This focus was understandable; it had a low-risk customer base, considerable expertise in unsecured lending and an advanced platform from its large, in-house store card operation.

What is perhaps more surprising is how selective the UK supermarkets have been. TPF and Sainsbury's Bank have focused on credit cards, unsecured loans, savings and insurance. Neither supermarket has competed head on with the banks by offering a full suite of products based around current (cheque) accounts. And both TPF and Sainsbury's Bank have withdrawn from the mortgage market, with neither building a large portfolio (at the time of writing, TPF offers a mortgage broking service and mortgages from First Active, part of the RBS Group).

Ultimately, while it may make good business sense, a selective approach limits the retailers to being no more than niche players in financial services. And it sits a little uncomfortably with the supermarkets' 'one stop shop' approach to core household shopping.

Small market shares

Second, even in their chosen markets, the retailers' market shares remain small.

Retailer banks – presence by market

Current accounts	<ul style="list-style-type: none"> No presence
Savings accounts	<ul style="list-style-type: none"> Both TPF and Sainsbury's Bank with portfolios of over £2 billion But UK market of over £600 billion at end 2006
Mortgages	<ul style="list-style-type: none"> Marginal presence, no meaningful market share TPF currently offering a 'mortgage finder' broking service and mortgages from First Active, part of the RBS Group
Credit cards and consumer loans	<ul style="list-style-type: none"> Both M&S Money and TPF have unsecured loan portfolios of over £3 billion But UK market of over £210 billion

Sources: Companies, Office for National Statistics, Bank of England, Authors' analysis

Both TPF and Sainsbury's Bank have retail deposit portfolios of more than £2 billion while M&S Money had retail deposits of approximately €1.3 billion at end 2006. However, this is in the context of total UK resident sterling bank deposits held by individuals and individual trusts of more than £600 billion at end 2006 according to the Bank of England.

Based on the most recent numbers available, both M&S Money (end 2006) and TPF (end 2005) have unsecured loan portfolios of over £3 billion while the portfolio of Sainsbury's Bank (end March 2006) is between £2 billion and £2.5 billion.

However, total UK consumer credit outstanding was £212.9 billion at end 2006. This implies that even in the UK unsecured lending market – a major focus for all three retailers – their combined market share was probably no more than 5% at end 2006.

Compare the supermarket banks with Egg, the internet-based bank launched shortly after them in 1998 by the Prudential insurance group (and acquired by Citigroup early in 2007). Like the supermarkets, Egg focused on credit cards and personal loans. As at end September 2005 (the quarter before Prudential bought out Egg's minority shareholders), Egg reported a UK unsecured loan portfolio of just under £6.4 billion, almost twice that of TPF and more than twice that of Sainsbury's Bank.

All three retailers are also active in the main personal insurance markets (motor, home, life, travel).

Tesco in particular has clearly built a substantial insurance business, particularly in the motor segment. TPF reports over 1.3 million in-force car insurance

policies. According to joint-venture partner RBS, TPF is the third-largest issuer of car insurance policies in the UK. TPF also reports over 400,000 home insurance customers and over 330,000 pet insurance policies, the second largest in the UK.

However, overall, to the extent it can be estimated from available data, the share of the general insurance business held collectively by the retailers' financial services businesses appears to remain comparatively small.

Assessment

Given their reputations for marketing, innovation and customer service, why have the major retailers not made more of an impact in financial services? Possible reasons include:

First, retailers' banking operations are not immune from the changing reputations of their parents. From the late 1990s, both M&S and Sainsbury's suffered declines in reputation and performance (though both have subsequently recovered), weakening their reputational advantage over the banks.

Second, there remain significant differences in operations, customer service and compliance between retailing goods and providing financial services. TPF has innovated with products such as travel insurance that can be bought 'off-the-shelf' by its Clubcard holders. But most account-based financial services are hard to 'retail' in a store environment. And large retailers' core skills and main sources of competitive advantage (for example, their sourcing expertise and buying power) given them less leverage in financial services compared with diversification into adjacent retail sectors.

Third, the retailer threat may have been blunted by competition from other new entrants – for example, the US credit card 'monolines' and direct banks such as Egg and ING Direct.

Ultimately, UK retailers have ended up in the curious position of partly competing and partly co-operating with the banks. With M&S's sale of M&S Money to HSBC in November 2004, it joined the supermarkets in operating in partnership with an established bank. TPF and Sainsbury's Bank are long-standing joint

ventures with RBS and HBOS respectively.

With all of the major UK retailer financial services ventures now at least partly-owned by a major bank, they remain firmly within the ambit of their notional competitors. Their willingness to partner the retailers (three of the big five UK banks now have retailer partnerships) suggests that the banks see the direct competitive threat to their own core retail businesses as limited.

Banking at the Checkout 2007-08 Updated Report Now Available

In June 2006, ECR published its landmark report on the record of leading retailers as providers of financial services. In view of the great interest in this report, an updated and expanded version is now available. The new report covers the latest developments, including the ambitious plans of Wal-Mart to expand its offer of financial services.

Written by Steve Worthington, marketing specialist at Monash University in Melbourne, and independent banking consultant Peter Welch, the report is essential reading for those in cards, banking and retailing.

Available from September 19 at a price of £750/€1,150.

To view the full synopsis visit:
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