



LEADERS OR LAGGARDS?

CANADIAN FINANCIAL INSTITUTIONS AND TECHNOLOGY

REMARKS BY:

**Helen Sinclair
Chief Executive Officer
BankWorks Trading Inc.**

**The Canadian Club
Toronto, Ontario**

November 3, 1997

Madam chairman, distinguished head table guests, ladies and gentlemen.

Let me start with an anecdote from a dozen or so years ago, when I was an employee of Scotiabank. One Friday evening, I headed downstairs to use what was then its only banking machine in the head office building - or for that matter in the Toronto downtown area. The machine was out of order. As I pondered the alternatives for my weekend grocery money, the bank's chairman emerged from the elevator. "How much do you need?", he asked. "A hundred bucks", I stammered. Out came his wallet and five \$20 bills. I still maintain it was the only interest free loan Ced Ritchie ever made!

Today, I could choose between a number of machines of my own bank, plus dozens belonging to others -- all within a five-minute walk of my office. Besides which I wouldn't care whether I had any cash or not, because I would probably be using my debit card -- assuming, of course, that I wasn't parked in front of my PC, wheeling an electronic buggy down the aisle of a cyber mall.

Which brings me to my topic for today's address: the role and state of technology in Canadian financial institutions.

In my new incarnation as an entrepreneur, I spend the majority of my days helping technology suppliers identify and market new applications for the financial sector and, in parallel, assisting financial institutions to source new technologies. My experiences to

date confirm what was my conviction from the outset: that technology leadership is the number one strategic issue facing Canada's financial industry. It is far more crucial to the success of our banks, for example, than being granted the insurance distribution or car leasing powers which have taken up so much time and thought in public debate. That will be my first point today.

My second point will be that our financial institutions have achieved much in some key areas of technology. But their overall position is second tier and they are being squeezed at one end by some of the world's largest financial institutions, with enormous information technology budgets, and, at the other end, by very specialized institutions, which live and breathe technology in every aspect of their operations.

My final point will be that I believe it is possible for our financial institutions to work their way to the top of the heap. But it will be a formidable challenge.

Why is technology so important? The answer, in a nutshell, is that it enables financial institutions to deliver higher quality services at lower costs. To take a simple example, it costs \$1 to process a cheque, 27 cents for a banking machine transaction and a penny for an Internet transaction. Lower costs for the bank translate into lower costs for the consumer. A bill paid by telephone, for example, costs 40 cents; a bill paid by mail will cost you more than that for the stamp alone.

And think about discount brokerage. Commission on a thousand shares of TD Bank will cost you \$ 35 if you access Green Line by phone as compared to \$29 when you buy over the Web. (Both look good in relation to full service commissions which, at today's share price, will run you well over \$600!)

Technology translates into sophisticated mathematical models and tools that enable financial institutions to offer GICs with stock index related interest rates, or to guarantee exporters predetermined exchanges rates. It also provides the tools that allow credit card companies operating off-shore to target with great precision Canadian consumers whose thirst for plastic is not yet satisfied.

Technology is not simply a tool, however; it is the basis for a new and better infrastructure that has revolutionized the financial industry as illustrated by the fact that banks alone are now the number two employers of IT specialists in this country, second only to the technology industry itself.

With this revolution comes much intensified competition.

Large banks and securities dealers now deliver your financial services electronically.

But so do ING, the Canadian subsidiary of a large Dutch financial conglomerate, and E*TRADE, an American owned discount brokerage firm.

And so soon, some people believe, may the likes of Rogers, IBM and Microsoft.

Let us then turn to the critical question: how do Canadian financial institutions rank? Are they leaders or laggards?

At one key level-- electronic access for consumers-- there is lots of good news here in Canada. The automation of our deposit institutions' branch systems is second to none: even branches in the far north, are on-line, in some cases through satellite hook-up. Our cheque clearing system is the fastest in the world. We consider it old hat and old technology that a cheque deposited in Gander Nfld. and drawn on a different bank in Coquitlam B.C. will be credited to your account immediately. But try that out on an American and you are guaranteed a look of utter amazement.

We have more banking machines per capita than any country in the world except Japan. Our Interac shared cash and debit system is the envy of the world. On average, Canadians use debit cards four times as frequently as Americans. Telephone banking will be used to process over a billion dollars of payments this year and will grow more than five-fold by the year 2000. And PC banking is now available at all seven of our large deposit institutions and many smaller ones as well.

The really good news is that Canadians are self professed technology junkies when it comes to financial services. Just think how often you hear people boast that they haven't been in a bank branch for months. Even those who profess no love lost for the glass towers - and there are still a few around - give our institutions high marks for technology. In a recent COMPAS public opinion poll, the financial industry emerged as the most

technologically adaptive sector of the Canadian economy, ahead even of the telecommunications industry.

So what is the story behind the story? What has put Canada in the number one spot for electronic delivery of financial services world-wide? Let me single out two factors.

Perhaps the most important has been our institutions' ability and willingness to cooperate with each other to achieve common standards on all payments fronts: from the magnetic encoding on cheques to common interfaces for plastic cards.

As things now stand, Canada is the only country in the world where financial institutions have committed that smart cards, regardless of brand, will work in all our subway turnstiles and phone booths.

Cooperation is not collusion, whatever the competition gurus may think. It is a response to the obvious reality that most financial transactions involve at least two players. Unless systems can talk to each other, a payment to one bank's customer drawn on another bank's customer will go nowhere.

Another plus has been the ability of our institutions to go beyond cut and dry "return on investment" business cases when considering new technologies and to take leaps of faith based on an understanding of important shifts in consumer attitudes. In this sense, our advances have always been about more than bits and bytes. They have been a subtle blend

of electronic technologies, knowing what customers want and how much they are willing to pay for it.

Mind you, these leaps of faith don't come easily, particularly when several institutions are at the table. One of my archival treasures is a six page letter written in 1988 by a bank president to his peers, which lays out, chapter and verse, his misgivings about the decision to launch debit cards. "Way too much, way too soon " was his view, although he did agree to join in with the majority.

By the way, it turns out there are major differences between women and men in the use of debit cards. Women like them because they hate being in debt, and because they feel uncomfortable carrying a lot of cash. Men, on the other hand, are more likely to say: "Why should I give up the interest-free period I get on my Visa or MasterCard? The result: Significantly more women than men cite debit cards as their preferred method of payment. Far be it from me, of course, to draw any conclusions about who should be doing the business cases for new technologies in our financial institutions!

So there is a lot of good news on the technology front. The bad news is that, for today's world it isn't enough. We are not keeping pace technology-wise with the best financial institutions globally. Some of them are very large in relation to our largest, but many are not. Most are American and they invariably regard the Canadian market as the obvious first step for international expansion.

At one end of the spectrum, mergers in the United States are producing gigantic institutions with enormous economies of scale and huge resources to invest in innovation. In 1996, for example, Chase Manhattan Bank spent \$2 billion on information technology, about the same as the entire Canadian banking industry. At the other end of the spectrum is a myriad of institutions—MBNA, Capital One, E*TRADE, State Street (many are not household names because they don't establish branches) specializing in everything from credit card operations to Internet brokerage, to mutual fund processing. Their size may not approach that of the biggest players in Canada or the United States. But, in many cases, they dominate their narrow line of business; and, without exception, they all cite technology as their most important strategic advantage.

The result? The technology performance and indeed the overall market performance of our financial institutions are threatened. By one closely watched measure, the ratio of expenses to revenues, Canadian banks began to under-perform the large U.S. banks in the early 1990s and my guess is that, as things stand, the gap will widen.

One thing is certain; whatever their size, foreign institutions will use their technology advantage aggressively as they enter the Canadian market. ING, for example, pays substantially higher rates of interest on savings accounts and Wells Fargo is using powerful data mining technologies to target Canadian small businesses and analyze their credit worthiness - all from its head office in California. It won't even look at unsolicited credit applications!

So our institutions are squeezed. On one side, they see mega institutions with large technology budgets. On the other side, are the very focused, often branchless, institutions with no overhead costs and no legacy problems - no old systems sitting in old computers written in obsolete languages—just state of the art technologies to identify, service and access the customer.

As you may have gathered, size in my view is not the main reason why we are losing ground to the Americans. I believe our most serious technology weaknesses are lodged in the internal culture of our institutions. Let me cite a few examples.

One, notwithstanding our successes in electronic delivery, we don't have the same single-minded focus on technology, we don't think technology in every aspect of our operations, the way the Americans do. We have not defined technology responsibilities throughout our institutions. There are entire parts of our organizations from finance to product management and, in some cases, the systems areas themselves, where the prevailing attitude still seems to be: "If it ain't broke don't fix it."

To see the difference, check out the Web site of Capital One Bank of Richmond Virginia: It lists 21 major press stories on the Bank in 1997; 15 of them originally appeared in the likes of Datamation, Computer World, Information Week and PC Week; they cover everything from systems architecture, to data warehousing to call centre hook-ups. And be in no doubt of Capital One's financial results: a return on equity of 23% and a price to earnings ratio of 17.5 for the third quarter of 1997.

Secondly, we remain wary of specialization. Even the largest American banks tend to specialize in a few key areas of expertise. There they invest heavily in innovation and, as a result, become acknowledged leaders - superbly good at what they are doing. This is particularly true of their back office operations. Few U.S. banks, for example, still run their own credit card operations, even though you still see the bank's name on their credit card. Outsourcing has spawned a large industry of card processors which achieve great economies of scale and provide a concentrated base for research and development. Our institutions are beginning to outsource. But the prevailing mood is fear it will lead to a loss of control and the pawning of customers.

A third issue, and one which I see almost daily in our company, is that Canadian financial institutions are reluctant to use small technology suppliers. They are good at forming strategic relationships with the likes of IBM, NCR, and the six large accounting firms (should I say four large accounting firms?). But small suppliers have a much tougher time even though they are the source of much of the recent innovation in the financial sector. Canadian technology suppliers face a particular challenge because they suffer from the age-old problem of not being able to get recognition in Canada before they have "made it" in the United States. And even success south of the border doesn't necessarily do the trick.

A number of our clients come to us after having successfully sold in the States. They tell us, "Bankers there are open to being shown you have a better mouse trap. In Canada,

they won't buy until you have convinced another major Canadian institution to buy.”

It's a little like that old chestnut of not being able to get a bank loan unless another bank is begging you to take its money.

The end result is that sales cycles for these suppliers can be perilously long—even when they do end up bagging the deal. Two to three years is not uncommon and this in the technology sector where financial analysts scour statistics called “time to market” and regularly pan products which take more than a year to achieve significant sales.

The bottom line? Technology is maybe the only area where the perception of the Canadian financial community surpasses the reality. It's not that we have been asleep at the switch. In fact, in one critical area, electronic delivery systems, we are the number one performers globally. In others, we would look good were it not for the U.S. financial industry nipping at our heels, with their full arsenal of IT strategies and tools.

There can be no doubt of the imperative for our institutions to be in the front ranks of technology globally. So here are a few modest suggestions.

One, be brutally honest about the areas where there will never be the same economies in-house as there would be going to an outside provider. Ask this question: if large American banks willingly have outsiders provide their credit card processing, why do we think we can do better in-house?

Second, commit to technological leadership in those areas where we have decided to specialize. Write it into our corporate goals, our job descriptions and our annual reports to shareholders. Document negative technology variances the same way we document our negative financial variances.

Three, continue to look for opportunities for cooperation among financial institutions, and try to shorten the mating dance that invariably precedes these agreements. A typical negotiation today has all the look of a standard Harlequin romance: the wooing, two-timing, jilting and and, ultimately kissing and making up. A certain amount of this may be inevitable, seeing that strong egos are involved. But picking up the tempo would be helpful.

Four , support our domestic suppliers. Rather than another high tech venture capital fund, how about a concrete commitment in our respective institutions to try out the new mouse traps of our own technology community?

Finally, keep our eye on our real competitors. They're not the software firms or cable or phone companies. Personally, I am convinced that most technology suppliers have no interest in head-on competition with financial institutions. What's more, I believe they would fail miserably if they tried. Being a good financial institution involves a lot more than being able to process an Internet payment. It is a position of public trust built on a broad base of sound, sustained and conservative risk management practices. Our real

competitors are other financial institutions, of many sizes and shapes, which share our culture and management philosophies. Their one defining difference is that, without exception, they are committed to technology as the linchpin of strategic advantage.

I recognize that my message today has been blunt. But this is not a small potatoes issue. It is about the competitiveness of our financial sector. Besides, our financial institutions have tended to perform best when the external challenge is the greatest.

It is my strong conviction that they can lever off their successes in electronic delivery systems and duplicate them on other technology fronts.

The action necessary is entirely within their court: no laws to change no regulatory hurdles to overcome. Their financial performance is at a cyclical high and it is their reinvestment strategies that can set them apart.

I can think of no better use of their intellectual and financial resources at this time than to put technology leadership at the top of their strategic priorities.