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Operations strategies of banks — using new technologies for competitive advantage

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Abstract

This paper discusses how new technologies are being employed by various banks to streamline their operations and creating sustainable competitive advantage. We use a conceptual operations strategy framework consisting of four elements: mission, distinctive competence, objective and policies to discuss the managerial implications of new technologies employed by various banks. It is concluded that operations must be recognized as a strategic function in banking institutions and investment in new technologies should be strategically directed to strengthen various operations decisions such as quality, process, capacity and facility.

Keywords: Operations strategies; Competitive advantage; Banking operations; New technologies

1. Introduction

The information revolution in computers and telecommunications technology has had and will continue to have a major impact on the financial services industry. Banks have been the most important users of US information technology. As far back as 1971 the financial service sector absorbed most of the R&D outlays of the computer industry. Banks have also had the biggest appetite for new technology and by all appearances this trend has continued (Pennings and Harianto, 1992). Technological advances have helped banks but at the same time increased non-bank competition. This increased competition has lead to fierce battles for profitable customers and products, consolidations, and the elimination of traditional geographic market franchises. Banks now have to compete with brokerage firms, investment companies, and insurance companies for transaction balances and cash management services. Large companies do not have to use banks exclusively as middlemen.

Computers enable these companies access to so much information that they can accomplish financing by borrowing directly from the money markets at lower expenses than if they went through a bank. An example of this type of financing is commercial paper. Commercial paper handles the short-term needs of companies for cash. The maturities are flexible from 2 up to 270 days, and brokers can issue the paper at rates below what banks would charge. This has eroded the banks traditional commercial customer base and has required banks to find other sources of revenue.

There is a struggle between banks and non-bank players for the elusive and discriminating customer. The battle for market share is being fought with technology as the competitive weapon of choice. A fundamental change is underway in the financial services arena. Has the banking industry been wasting money on technology?

2. Banking operations strategy model

In this paper, we purpose that the implementation of new technologies has brought the operations function to the spotlight. For some banks operations are spotlighted not by choice but by market forces, and others have

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recognized the importance of operations role. In simple terms, operations management in banking is a transformation system that converts inputs such as employees, computer equipment, facilities, energy and money into outputs that include loans and deposits.

What guidelines should bank operations managers follow? The bank's Board of Directors must decide on what business strategy it will us, for example, cost leadership or product differentiation. A careful analysis of external and internal forces must be done because the strategy defines how the bank intends to compete. The external environment includes the competition, customers, economics, technology, and social trends. Internal considerations include resources, the skills of the work force, facilities, and current systems. Based on which business strategy the board of directors chooses, the bank's operations strategy must be aligned with the business strategy.

Let us look at an example of a mission statement of Huntington Bancshares Inc., a bank located in Columbus, OH. The mission of Huntington Bancshares Incorporated is to meet the financial services needs of individuals and businesses. "*We seek a dominant position in the markets where we choose to compete by providing high quality, differentiated products and legendary customer service. Our thrust for business development is to penetrate existing markets, deliver products and services to new geographic markets and strategically manages our business mix to achieve a superior result*" (Huntington Bancshares, 1994). It is clear from its mission statement that the bank is implementing a product differentiation business strategy.

The operations strategy must also examine both the external environment and the internal environment. Once this analysis is complete, an operations strategy can be formulated. There are four core requirements for an effective operations strategy: (i) mission; (ii) distinctive competence; (iii) goals; and (iv) policies (Schroeder). The *mission* statement identifies the purpose of the operations function in relation to the bank's business strategy. The mission should prioritize the four operations goals, that is, dependability, efficiency, flexibility, and quality. The operations goals will be prioritized based on the chosen business strategy of low-cost or differentiated. For example, based on Huntington's business strategy mentioned above, quality would rank first.

A *distinctive competence or competitive advantage* is what operations must excel at relative to the competition. For example, let us look at First Union out of North Carolina. They have determined their competitive advantage is in their delivery system. First Union envisions an officer preparing a credit offering, assisted by various internal bank systems, on a computer. Their new commercial banker system enables account officers to use PCs to access a wide range of information, as well as multitasking capabilities. This allows officers to react quickly to a customer need. Thus, if an account officer is preparing a credit offering and a call comes in from another customer requesting that the officer check on the status of a loan application, the officer can inquire about the application status and simultaneously continue to calculate all the information for the current loan application (O'Henry, 1992).

The goals (i.e., *dependability*, *efficiency*, *flexibility*, and *quality*) for banking operations should be clearly defined. *Dependability* refers to the bank's ability to deliver the service when and where the customer needs it. *Efficiency* refers to the bank's ability to deliver the service in a cost-effective matter by an effective use of capital. *Flexibility* is the bank's ability to expand and contract system and computer requirements to meet the need for new loan or deposit products and changes in the volume of business.

The final core element for operations strategy is *policies*. The next section of this paper discusses these policies in detail.

3. Operational policies

Operation policies define how the goals of operations will be achieved. These policies should be developed to accomplish the goals for banking operations (i.e., dependability, efficiency, flexibility, and quality). Operations policies should be developed for every one of the five decision categories. The following discussion gives examples from various banks and, provides insight to bank operation managers on current practices involving policies and strategies.

3.1. Quality

One way to improve quality is to improve communication with the bank's customers. Improving communications with customers is essential for banking now and in the future. Communication includes all customer contact, from monthly statements to personal contact at the branch. Each contact is vital because banking is an intangible service, which cannot be readily assessed by potential customers before the service is delivered. Therefore, with each and every contact the bank leaves an impression with that customer. The quality must be consistent each time in order to maintain and increase the customer base. Listed below are top ten competitive priorities which banking executives feel will provide them with the tools necessary to help achieve a competitive advantage. They are ranked in order of most importance to the executives (Roth and Velde, 1991).

1. Courteous service
2. Consistent service
3. Enlarge customer relationships