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List of abbreviations

ATM	Automated Teller Machine
B&M	Brick and Mortar
CEE	Central and Easter European
EEA	European Economic Area
FDI	Foreign Direct Investment
GBA	German Banking Act
ICT	Information and Communication Technology
JV	Joint Venture
MNB	Multinational Bank
MNE	Multinational Enterprise
RDC	Remote Deposit Capture
SMEs	Small and Medium Sized Enterprises
TCE	Transaction Costs Economics
WOS	Wholly Owned Subsidiary
ZEW	Centre for European Economic Research

1. Introduction

In the aftermath of the recent financial crisis[1] and in times in which banks rediscover the private individual – also described as the renaissance of retail banking[2] - significant attention is now being paid to the market entries of foreign multinational banks.[3]

The German retail banking market is highly competitive. Private, cooperative and state-controlled savings banks compete intensely for market share with hardly any cooperative activities among the groups. As savings banks are owned by German states, towns or local authorities, they are protected by law from takeovers by institutes from the other banking sectors.[4] Due to the high fragmentation of the German market, hardly any bank has dominant market power. The five largest banks have a total market share of only 20 percent and new competitors enter the market and attract customers with aggressive price differentiation offers.[5] The strong competition among private banks, savings banks and co-operative banks results in low profit margins by international comparison. The profit potential in German private-customer business has fallen for many years. From 2000 to 2006 total income from the financial service providers in Germany, measured by the distribution of financial products with private customers, fell approximately 15% from € 67.5 billion to € 57.4 billion.[6] Though the retail banking sector has experienced some increase in profits due to cost reduction and reduced loan failures in 2007, market potential still stagnated in 2009.[7]

Since the financial crisis has raised the awareness of the threats of investment banking, many banks have refocused on core business activities in order to maintain their solvency through increased account deposits. Banks need money to grant loans to private individuals or enterprises, provide investment opportunities, finance consumer goods or simply realize baking transactions. Yet, the recent financial crisis caused distrust among the banks and loans will not be granted as

[1] Plickert (2009)
[2] Deutsche Bank (2009)
[3] Köhler and Lang (2008)
[4] Spiegel Online (2007)
[5] Welp (2009)
[6] Zeb/rolfes.schierenbeck.accosiates (2008)
[7] McKinsey & Company (2007); Zeb/rolfes.schierenbeck.accosiates (2008)

easily as before. On the consumer side, the financial crisis has increased the demand for secure money investments. A survey of 230 highly ranked managers from private, savings and co-operative banks on the effects of the crisis on their business indicates that banks have concentrated more intensively on business with private customers both during and after the latest crisis. Moreover, customer demand for certificates, company shares or funds has fallen significantly, while the demand for standard retail banking products such as call money accounts or account books has increased substantially.[8]

In spite of its high competitiveness and low profit margins, the German retail banking market is still attractive for foreign banks. Foreign MNBs are increasingly able to penetrate the market for private individuals.[9] In particular, they gain market share through new products, decreasing prices, standardized processes and innovative marketing, whereas domestic banks have often relied on continued customer loyalty.[10] Although foreign multinational banks in Germany have usually concentrated on large domestic corporations engaged in international transactions[11], they now enter the market for private and small corporate clients as well[12]- a trend that has been supported by the development of internet technology and other new marketing - channel options.

The distinctive characteristics of the German banking market raise several questions concerning both entry mode and business model considerations of multinational banks. Should a multinational bank engage in cross-border lending or rather enter the market via foreign direct investment? How do the development of economic, political-legal and social-cultural factors in the German market affect a multinational bank`s entry mode and business model choice?

This thesis distinguishes between the non - equity entry modes of cross-border lending and alliances as well as the equity entry modes of representative offices, branches, subsidiaries, and JVs, both from a Greenfield investment and an acquisition point of view. Each of these organizational entry mode forms has

[8] Welp (2009)
[9] Reitz (2005)
[10] McKinsey & Company (2007)
[11] Hersh and Weller (2002)
[12] Köhler (2008)

distinctive advantages and disadvantages. Hence, the main focus of this thesis is to provide a broad understanding of the distinctive market entry and penetration strategies in light of macro and micro economical developments in Germany.

1.1 Research Objective

This thesis examines entry mode choice decisions and business model considerations of multinational banks entering the German retail banking sector. The objective is to evaluate the affect of current market developments on their entry mode decisions.

In light of the financial crisis and the banks` rediscovery of the private individual, the German banking sector is currently experiencing a renaissance, resulting in increasing industry rivalry. At the same time, the processing of bank transactions and customer services is becoming increasingly independent of the branch distribution channel and the adoption of new technologies is substantially affecting the allocation of retail banking services.[13] The technological evolution is exemplified by the emergence of web-based direct banks, which have been able to penetrate the retail banking market with low-cost structures, innovative ideas and distinctive service thinking.

Eventually, the growing importance of the internet and other technological means as distribution channels on the one hand and the remaining strong demand for personal consultation on the other hand require a customer-oriented multi-channel management of the banks.[14]

This paper contrasts the two opposing ends in the field of retail banking distribution channels. It simplifies the entry mode choice between direct banks that solely operate through the internet and brick & mortar banks, which solely operate through a branch network. Furthermore, it differentiates between branch entry via Greenfield investment and subsidiary entry via acquisition.

Two major questions will be addressed:

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[13] Deloitte (2010)
[14] Welp (2009)

Firstly, to what extent do demographic and technical developments favor a direct bank entry mode over a brick and mortar bank approach in Germany?

Secondly, what affects the decision in favor of a branch entry mode via Greenfield investment as compared to a subsidiary entry mode via acquisition in Germany?

1.2 Structure

This thesis is systematically divided into two different complexes - a theoretical and a practical. After a classification of essential banking terms in the section 2, Section 3 then describes relevant market entry theories – namely the Transaction Costs Theory and the Eclectic Theory as well as market entry strategies – namely the offensive and the defensive strategies of expansion.

In section 4, the German retail banking market is analyzed within the five forces framework. The goal of this examination is to evaluate market attractiveness and to identify micro and macroeconomic developments that may shape the market in the future.

Given the theoretical framework of section 3 and the knowledge of industry structure and trends of section 4, section 5 explores the decision driving factors of entry mode choice. In this section, cross-border lending, alliances, joint ventures and representations will be discussed. Furthermore, this section indicates what affects the decision in favor of a branch entry mode via Greenfield investment as compared to a subsidiary entry mode via acquisition and to what extent demographic and technical developments favors a direct bank entry mode over a brick and mortar bank entry mode in Germany.

Section 6 introduces the SWOT analysis as well as the Service Marketing Mix and applies these concepts to the ING - DiBa case study. It illustrates how ING- DiBa penetrated the German retail banking market with both the implementation of the direct banking business model and the exploitation of external opportunities.

Finally, this thesis concludes with a summary of the major findings.

2. Classification of Banks

2.1 Bank

This paper refers to banks as defined in the German Banking Act. Section 1 GBA defines financial institutes as enterprises which pursue banking transactions, insofar as the extent of these transactions requires commercial business operations. At least one of the following transactions has to be carried out: security transactions, credit transactions, payments transactions or other banking business. The enterprise which pursues banking transactions in Germany requires the permission of the BaFin (Federal Institution for Finance Service Supervision) according to section 32 GBA.

2.2 Direct Bank

Direct banks are credit institutes which operate without a branch network and utilize the internet and the telephone as direct communication channels through which banking transactions are realized and marketing and customer service takes place. Thus, direct banks establish cost advantages which they usually transmit in the form of attractive terms.[15]

2.3 Brick and Mortar Bank

A brick and mortar (B&M) company is a traditional "street-side" business that deals with its customers face to face in an office that the company owns or rents.[16] A brick and mortar bank serves consumers in a physical facility as distinct from providing online or telephone services only. The term brick and mortar is not a generally valid classification of a bank, but in the jargon of e-commerce it is frequently employed to distinguish from internet based enterprises. In this thesis, the term brick and mortar bank is employed to differentiate between a direct bank that operates through direct channels and one which operates solely through its branch network. The term brick and mortar is also distinguished from the term click and mortar, which is an expression for a form of multi-channel retailing in

[15] Deutsche Bundesbank (2010)
[16] Investopedia Dictionary (2010)

which both electronic distribution channels (click) and physical premises (mortar) are utilized.[17]

2.4 Multinational Bank

Multinational banks are defined as banks that have a physical presence in more than one country. In contrast, international banks engage in cross-border operations but do not establish a physical presence in foreign countries.[18]

2.5 Retail Bank

There is no generally valid classification of retail banking in theoretical literature or in practice.[19] A distinction in retail banking is often made with regard to its target clientele. In this regard, some authors define retail banking as the offering of banking and financial services to individuals and small and medium sized enterprises.[20] Other sources define retail banking as the provision of these services solely to individuals.[21] This paper employs the following classification of retail banks: *`A retail bank is a bank that caters for ordinary individuals and small business, as distinct from large corporations. Retail banking operations offer deposit facilities, lend money, transfer funds and are prepared to deal in relatively small amounts.´*[22] In contrast to private and corporate banking, retail banking considers private clients with low to average income as well as small corporate clients

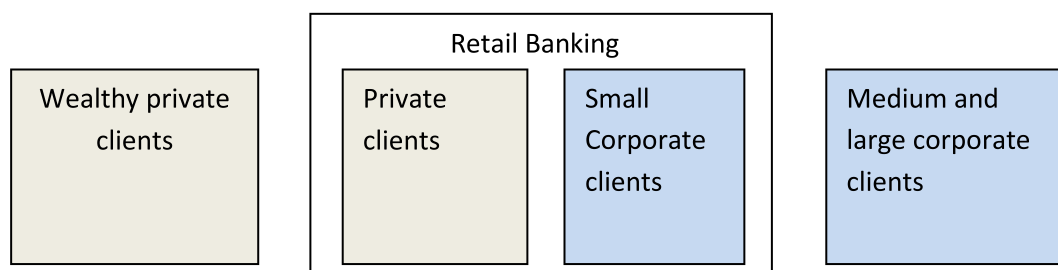

Figure 1: Classification of retail banking clients

(own illustration based on Swoboda, 2004)

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[17] Gabler Wirtschaftslexikon (2010)
[18] Hersh and Weller (2002)
[19] Müller and Jöhnk (2005)
[20] Pond (2007); FinanceWiki (2008); Tremblay and Tremblay (2007)
[21] Frei, Harker and Hunter (1998); Online: Businessdictionary.com (2010); Investoglossary.com (2010),
[22] Essvale Corporation Limited (2007)

3. Market Entry Theories and Strategies

3.1 Transaction Costs Theory

In the transaction cost theory, developed by Ronald Coase and Oliver E. Williamson, a comparison of transaction costs determines the optimal form of organization. In TC Theory the entry mode decision is a tradeoff between the control and the costs of resource commitment. Entry modes vary in three major aspects: the cost of resource commitment, control as the level of ownership and environmental risks that may affect the committed resources. Hence, high-control modes increase both risk and the potential return.[23]

Williamson differentiates between ex-ante and ex-post transaction costs. Information and searching costs are incurred ex-ante in the process of collecting market information and identifying suitable partners. Negotiation and contract costs arise ex-ante due to negotiations, legal advisory and the determination of contractual terms. Monitoring costs develop ex-post for activities which serve to control contractual obligations. Conflict and enforcement costs arise ex-post due to the different interpretation of the contract and the costs of enforcing contractual regulations with sanctions, negotiations or through court proceedings. Adaption costs are incurred due to ex-post changes in contractual agreements that become necessary because of unpredictable developments.[24]

TCE assumes the existence of bounded rationality and opportunism. Bounded rationality describes the limitation in human processing of information and the planning of possible outcomes. Opportunism describes the notion that humans may act in a self-interested manner by manipulating information and being dishonest. The consequences of these assumptions are incomplete contracts and moral hazards.[25] Vice versa, opportunism occurs because firms can not write complete contracts.

The size of the transaction costs is determined in each case by the characteristics of *asset specificity, uncertainty* and *frequency*. *Asset specificity* arises when the actor in the market undertakes specific investments in order to fulfill his contractual

[23] Chen and Mujtaba (2007) p.322
[24] Kieser and Ebers (2006) p.278
[25] Magill and Quenzii (1996) p.11

obligations. It refers to the degree to which long-lasting human or physical assets are bound in a specific relationship and thus to the extent to which they provide value in the context of a different situation.[26] In TCE, markets can hardly solve the problems that high *uncertainty* creates in combination with bounded rationality and threats of opportunism. *Uncertainty* includes environmental and behavioral uncertainty. Environmental uncertainty refers to political, legal, cultural and economic uncertainties that may affect the success of business transactions. Behavioral uncertainty states that bounded rationality and the threat of opportunism result in the high costs of monitoring a partner company.[27] If the similar transactions are repeated frequently, learning effects and economies of scale occur and will reduce the transaction costs.

3.2 Eclectic Theory

The eclectic theory[28] (or OLI paradigm) was developed by John Dunning and is a framework that merges different economic theories which explain foreign market entry patterns of multinational corporations.[29] It states that the internationalization of MNCs is determined by three sets of independent variables: ownership advantages (or firm- specific advantages), location advantages (or country specific advantages) and internationalization advantages.

The ownership advantage considers the competitive advantages of MNCs arising from firm-specific characteristics such as size, monopoly power, economies of scale, management, brand name, technology and other resource capabilities.[30] These advantages are usually intangible assets and can be transferred at low costs.[31] The greater the competitive advantage of the MNC is, the more likely it is able to start or to increase its foreign production.[32]

The location advantages arise from country specific benefits that can be divided into three categories. Firstly, a host country may have economic advantages, comprising qualitative and quantitative factors such as production, transports costs,

[26] Dietrich (1994) p.18
[27] Brouthers and Brouthers (2003) p.1183 - 1185
[28] Dunning (1980); Dunning (1988); Hill, Kwang and Kim (1990)
[29] Dunning (2002)
[30] Forsbaeck and Oxelheim (2004)
[31] Griffin and Pustay (2006)
[32] Dunning (2002)

communication costs, market size or tax incentives. Secondly, a host country may offer political advantages, in particular governmental policies that may influence market entry. Thirdly, a host country may provide social and cultural advantages, including the psychic distance between the foreign and the domestic country as well as language or cultural aspects that may have an impact on the market entry decision. The higher the attractions of the specific location, the more likely it is that MNCs will exploit their ownership advantage by entering the foreign market.[33] Because of the existence of transactions costs, the internationalization incentive advantage states that it must be profitable for the MNC to exploit these advantages itself rather than through local companies (e.g licensing).[34]

In economic literature, the OLI paradigm has also been applied to the banking sector. In this regard, ownership advantage may include easy access to a vehicle currency. Locational advantages may include country-specific regulations and entry barriers. Internationalization advantages can be information advantages and access to local deposit bases.[35]

Many empirical studies on the banking market have utilized the eclectic paradigm as a basic framework. For example, a study of bank entry into CEE markets concludes that the ownership advantages of foreign MNBs are strong compared to banks in emerging markets, and especially when the foreign country experiences a banking crisis.[36] An application of the OLI paradigm to the Spanish banking market has shown that bank size and multinational experience of MNBs favor stronger commitment in the foreign country, whereas distance is an entry barrier.[37] However, theoretical literature also states that in service industries clients close to the MNBs headquarters may be served from this location, whereas clients in distant markets require a physical presence of the MNB in the foreign country, which favors a foreign market entry with increasing distance.[38]

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[33] Dunning (2002)
[34] Hagen (1997)
[35] Yannopoulus (1983)
[36] Uiboupin and Sorg (2006)
[37] Blandón (1998)
[38] Blondón (1998); Terpstra and Yu (1988)

3.3 Strategy of Defensive Expansion

A common approach employed to explain the expansion of MNBs involves the theory of defensive expansion, which is also referred to as the ´follow-the-customer´ argument.

This theory states that MNBs expand abroad in order to provide services for domestic clients, which are often large enterprises that have entered a foreign market.[39] The provision of financial services in the foreign country usually requires a presence at important economic centres. Hence, to some degree, expanding corporations impose pressure on their domestic banks to follow-up.[40]

The term ´defensive´ is derived from the idea that a failure to expand may lead to a loss of the client, not only in the foreign country, but also in the domestic one, as the client may associate with a foreign MNB.[41] Consequently, MNBs which pursue this strategy seek to prevent losses rather then to generate new profits in the foreign market.[42] Furthermore, the domestic bank has an incomparable competitive advantage over banks in the foreign country with regard to the knowledge of customer needs , the respective risk of credit default as well as an interest in cross-selling products such as financial advisory.[43]

Due to earlier business relationships with the client, the domestic bank has reduced costs for examining the financial capacities of the respective enterprise and thus can offer cheaper services.[44] Most foreign entry evidence supports the defensive expansion theory.[45]

A study on this theory with respect to retail banking has revealed that MNBs sometimes expand abroad in order to provide banking services to specific communities.[46]

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[39] Trend im retail-banking , köhler
[40] Henneberger and Graf (2000)
[41] Mullineux and Murinde (2003)
[42] Naaborg (2007)
[43] Knoop (2006)
[44] Bhattacharya (1994)
[45] Bhattacharya (1994); Naaborg (2007)
[46] Tschoegl (1987)

3.4 Strategy of Offensive Expansion

MNBs that offensively expand abroad primarily seek to increase their customer base both in the home and in the foreign country. Firstly, the establishment of foreign branches and subsidiaries enables the MNB to expand their services to domestic residents who benefit from the international orientation of the bank. These may include customers that have business partners in the foreign country. Secondly, MNBs may target new customers in the foreign country, in particular MNEs or foreign subsidiaries of domestic enterprises. As the MNB must in both cases entice customers away from other banks, the MNB has to offer attractive and competitive conditions for their financial services.[47]

[47] Büschgen (1998), p.604

4. Industry Analysis: German Retail Banking Sector

4.1 Porter`s Five Forces

In the school of Industrial Economics, the five-forces model has established itself as a core element of industry analysis. Porter`s analysis framework is built on the following five market forces that shape the strategy of competitors: threat of new entrants, threat of substitute products or services, bargaining power of buyers and suppliers as well as rivalry among existing competitors.

Porter's concept is based on the knowledge that the strategy of an enterprise must orient itself to its market environment, whereby the competitive strategy arises from a differentiated understanding of the market structure and the knowledge of how it changes. The effects of these forces determine the intensity of the competition in a market and with it its profitability and attractiveness. Therefore, the aim of the enterprise strategy should be reflected in the search for possibilities for the reduction or use of these competitive forces relative to its own enterprise. In this regard, Porter`s model is conducive to the analysis of the driving forces working in the respective industry.

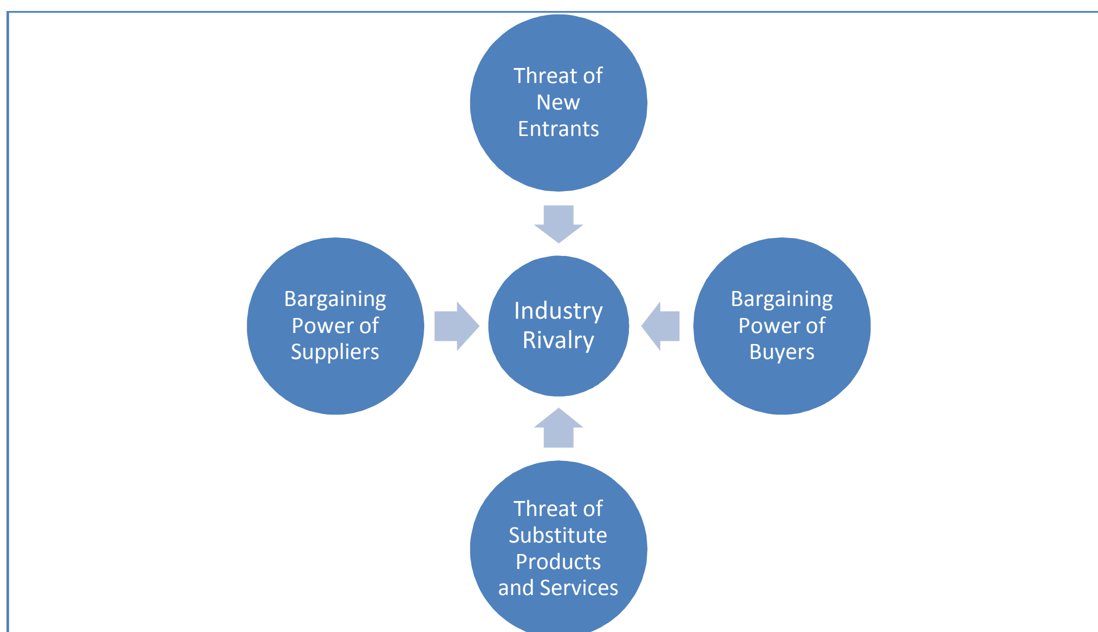

Figure 2: Michael E. Porter`s five forces model
(Own illustration based on Porter, 1979)

Porter`s framework is a useful and frequently utilized analytical tool to describe the foundations of industry competition.

A high degree of *rivalry among the existing enterprises* leads to high competitive pressure and can lower profit margins and the profitability of individual enterprises. In situations in which a large number of enterprises target similar market segments with comparable strategies, in which the market grows slowly, price is the most important differentiation factor and high exit barriers exist, a negative impact on the industry's profitability is effected.[48]

The *threat of new entrants* can be determined by the entry barriers of a market. The competitive pressure on existing enterprises increases with low entry barriers. In such a situation important elements of the market (e.g, shares of the market, price level) can change due to the entry of new market participants.[49]

The *bargaining power of buyers* determines to what extent customers can influence enterprises by the amount of consumption and the pressure on margins. Important indexes of a high degree of buyer power include: high fixed costs in the industry, existence of supplements of the product or service, high degree of customer concentration, customers` knowledge of production costs, possibility of a reverse integration of customers, high growth rates of the market and a strong individualization of customer demand.[50]

The *bargaining power of suppliers* affects industry profitability if, for example, a concentrated supplier group dominates over existing enterprises in the market, which are not important buyers for the suppliers. Then the industry faces high margin pressure by the suppliers.

A *threat of substitute products and services* exists in particular if cheaper or higher-quality products and services are able to reduce existing sales volumes of a market or an enterprise.[51] The future sales potential of existing enterprises becomes limited and industry competition increases.

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[48] Porter (1985)
[49] Porter (1979); Recklies (2001)
[50] Recklies (2001)
[51] Recklies (2001)

Critics of this model state that it neglects the impact of complements as a sixth force of the industry, since they may facilitate or hinder the commercialization of certain goods. However, Porter argues that complements are not a force itself but they affect profitability in the way that they influence the five forces and that `the strategist must trace the positive or negative influence of complements on all five forces to ascertain their impact on profitability`.[52]

One limitation of this model is based on studies which indicate that company-specific factors may have a more important impact on profit than industry forces.[53] Furthermore, the model suggests relatively static and stable market structure, which makes it difficult to assess contemporary dynamic markets.[54]

The model does not assess the impact of the parent company on its subsidiary, which is especially important in the banking sector, in which parent companies often have a strong impact on the performance of their subsidiary or branch. The parenting advantage includes the stand-alone influence through monitoring and influence on management decisions or capital expenses. Furthermore, parents create value by enhancing synergies within the group, offering corporate functions or managing portfolios.[55]

4.2 Rivalry among existing competitors

In this section the intensity of competitive *rivalry among existing competitors* in the German retail banking sector is discussed. In this regard an analysis of *industry structure*, *industry growth* and *exit barriers* will be conducted.

Industry structure: The German banking market is characterized by a three-pillar system which is reflected by the strict distinction between public-law banks, cooperative banks, and private banks.[56] Each pursues different goals and is subject to different regulations. Private commercial banks pursue the goal of profit maximization, whereas saving banks serve the public contract of offering secure

[52] Porter (1997)p.11
[53] Zack (1999)
[54] Recklies (2001)
[55] Goold, Cambpell and Alexander (1994)
[56] Gramlich (2005)

saving possibilities and loans. Cooperative banks primarily serve the economic interest of their members.[57] In terms of total balance sheet volume, the German banking market is structured as follows.

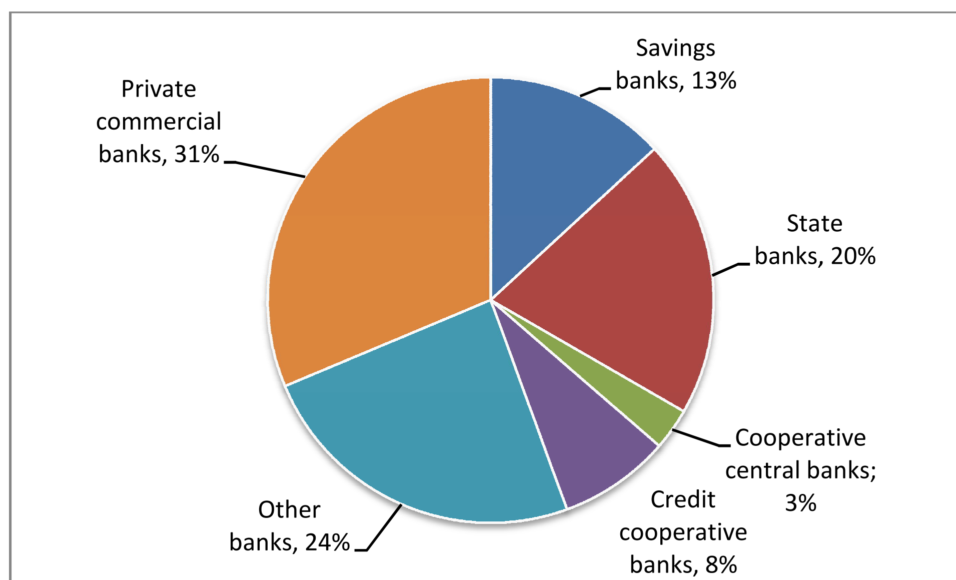

Figure 3: Structure of the German Banking Sector
(own illustration, based on Schrooten, 2009)

Public-law banks, including saving banks and state banks, amount to 33% of the total balance sheet volume of banks in Germany. However, state banks generally do not participate in retail banking. The cooperative bank sector amounts to 11% of the total, including cooperative banks, which participate in retail banking and cooperative central banks, which primarily serve large corporate clients. Private commercial banks, including large German Banks (Deutsche Bank, Commerce Bank, Post Bank, Hypovereins Bank), private banks and foreign banks, amount to 31% of total balance sheet volume. According to a recent survey of the Center for European Research (ZWE), 43 % of experts state that the three-pillar system is important or very important and 33 % state that it is the critical factor responsible for the low number of cross-border mergers and acquisitions in Germany.[58]

In order to describe industry rivalry among major banks that participate in the retail sector, the following table illustrates the number of customers per bank in Germany:

[57] Engerer (2006)
[58] Köhler (2008b)

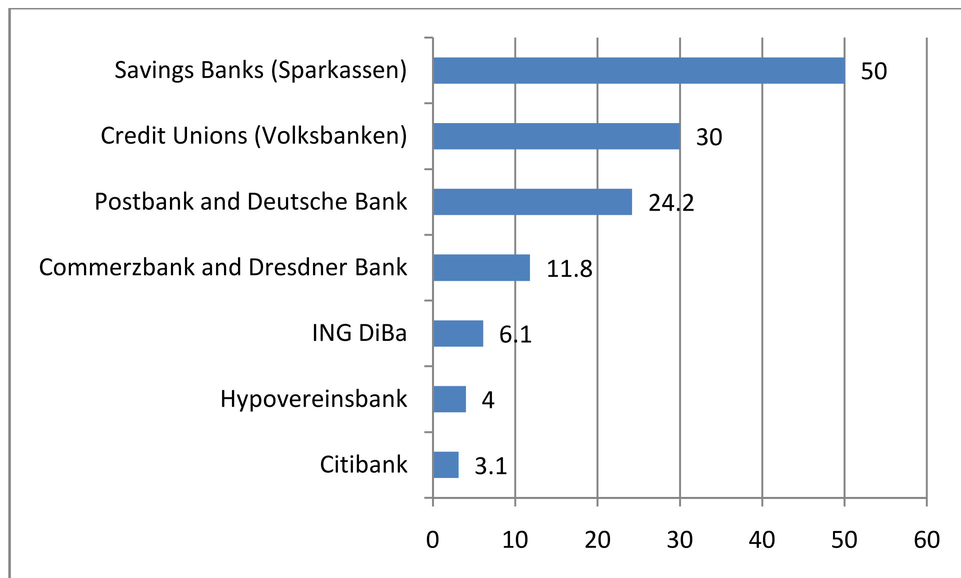

Figure 4: Customers of German Banks at the end of 2007 in millions
(own illustration based on Deutsche Bank, 2008)

With approximately 50 million customers, savings banks are the market leader in the German retail banking sector. Although state liability assumption for savings banks was abolished in 2005 because the EU saw in it an unacceptable subsidy to the disadvantage of private banks, customers still associate the name `Sparkasse` with state guarantees. The specific characteristic of a saving bank is based on its public contract in that it has to accept customers with poor credit-worthiness, that profits should be used to enhance public wealth and that the middle class should be supplied with loans.[59]

With approximately 30 million customers, cooperative banks are the second major player in the German retail banking sector. Nearly half of these customers are members of the cooperative banks.[60] In contrast to the profit maximization goal of private commercial banks, their aim is to fund their members and secure their economic independence. Although cooperative banks are economically and legally independent in the different regions, they appear uniformly as a group under the brand of "Volks- und Raiffeisenbanken". With regard to growth in customer base, cooperative banks benefit from the advantage of having the regional flexibility that

[59] Kruck (2008)
[60] Online: Raiffeisen Bank Homepage

allows for topical advertisement as well as a centralized management focus on improving reputation.[61]

The third group comprises the major private commercial banks, including Deutsche Bank, Postbank, Commerzbank and Hypovereinsbank. Deutsche Bank is a leading multinational investment bank, but with relatively low market share in the retail banking market. Deutsche Bank (9.7 million clients) is acquiring Postbank (14.5 million clients) with its broad branch network in a three-step process. Together they have 24,2 million clients. However, Heino Ruland from the analyst company Frankfurt Finanz Partner argues that Deutsche Bank might not be able to capitalize on the financially weaker Postbank clients, as Deutsche Bank is specialized in corporate clients.[62] With regard to rivalry intensity and market profitability, Rainer Neske, supervisory board member and head of private & business clients of Deutsche Bank, emphasizes that the German retail banking market is too fragmented to be highly profitable and that Deutsche Bank does not seek to compete on the price level but defines itself through performance, quality and consultancy.[63]

Commerzbank is the second largest private commercial bank in Germany. After the acquisition of Dresdner Bank in 2009, Commerzbank now serves more than 12 million clients (of these 11 million private and one million corporate clients) and pursues the goal of becoming the market leader in Germany.[64]

UniCredit Bank AG, with the brand name Hypovereinsbank (HVB) is a subsidiary of UniCredirS.pA and is the third largest private commercial bank in Germany. HVB serves approximately four million clients, predominantly in north Germany and in Bavaria. As its retail banking segment could only report marginal profits in 2009, speculation about a sale or acquisition in this segment has come up. As the Swedish SEB (Skandinaviska Enskilda Bank) is considering selling its German retail segment with 174 branches and one million clients, experts now regard HVB as a major buying candidate.[65]

[61] Schwarzbauer (2009)
[62] Kreiler (2008)
[63] Deutsche Bank (2009)
[64] Kreiler (2008)
[65] Höpner and Nagl (2010)

ING DiBa AG is a subsidiary of the Dutch ING Group and serves over 6 million clients. In contrast to savings, cooperative and the major private commercial banks, ING DiBa is specialized in direct banking, which distributes services via telephone, the internet or post instead of through branches. In Germany ING DiBa is the leader in direct banking, but there are many other direct banks, such as Comdirect (a subsidiary of Commerzbank), Volkswagen Bank or DAB Bank (a subsidiary of HVB). Competition takes place not only among direct banks but also between direct and branch banks. For instance, many saving banks have blocked the opportunity for customers of direct banks to withdraw cash from their automated teller machines. As savings banks can only charge Euro 1.74 for withdrawals via visa cards, they fear that direct banks can gain market share by offering attractive account options, with a convenient wide-area ATM provision.[66]

Targobank (former Citibank Deutschland) was acquired by the French cooperative bank Crédit Mutel and now serves more than 3.4 million clients in Germany in 2010. The bank is specialized in private retail customers with branches and direct banking.[67]

In conclusion, the degree of concentration in the German retail banking market is very low, which reduces the overall profitability of this sector for two main reasons: Banks earn higher profits in concentrated markets, as they obtain either monopoly rents (structure-conduct-performance paradigm) or due to high market shares that are gained by more efficient and profitable banks (efficient structure hypothesis)[68]. As retail banking services are largely standardized, product differentiation is low and price differentiation is often the only option. As public-law banks serve other interests than profit maximization, existing private banks and MNBs that want to enter this market have a competitive disadvantage. The low switching costs of clients intensifies competition on the price level and thus reduces the profitability of the market. However, brand identification and customer relationships are also important, which decreases the willingness of clients to switch solely on the basis of price comparison. In summary, market structure indicates a very high degree of rivalry among existing competitors.

[66] Online: Financial Times Deutschland (2010)
[67] Targobank (2010)
[68] Havrylchyk and Jurzyk (2006) p.15

Industry growth: In this section, industry growth will be examined in a dynamic analysis of three relevant market growth indicators: the future long-run development of the German population, the historical development of the number of banks and branches in Germany and the historical development of market-share allocation in the context of major retail banking activities.

In the long-run, market growth depends on the future numerical development of the market`s customers - the German population. As the growth of population through birth and immigration is smaller than its decrease by virtue of the mortality rate and emigration, the Federal Statistical Office in Germany estimates a sharp decline of the German population.

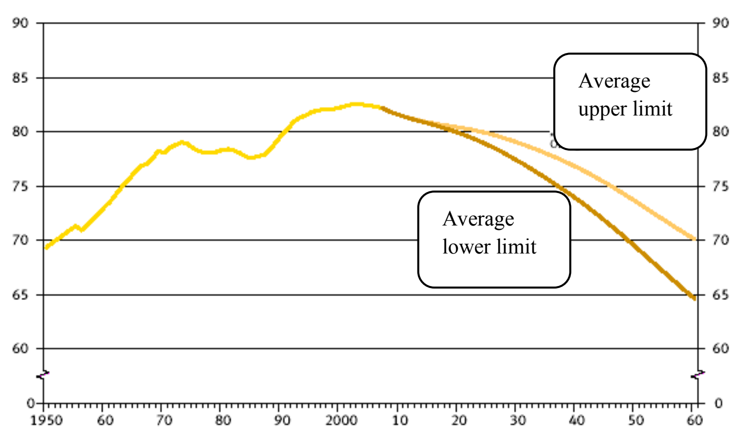

Figure 5: Estimated Development of German Population (in millions)

(Federal Statistical Office, 2009)

The Federal Statistical Office predicts that the trend of decline in population since 2003 will continue and intensify. Whereas approximately 82 million people lived in Germany in 2008, only between 65 million (average lower limit of the population with 100.000 immigrants yearly) and 70 million people (average upper limit of the population with 200.000 immigrants yearly) will reside in Germany in 2060. Furthermore, the decreasing number of births and the ageing of the current, strongly represented, middle age group will lead to substantial changes in the age structure of the population. From 2008 to 2060, the proportion of people from 65 to 80 years will increase 15 % to 20 % and the proportion of people over 80 years of age will increase from 5 % to 14% of the population.[69] The

[69] Federal Statistical Office (2009)

implications of the aging population for banks will be discussed in the comparison between direct banks and B&M banks in section 6.6 of this thesis.

The second indicator of industry growth deals with the number of banks and bank branches in the German market. The overall number of banks in Germany decreased from 3785 in 1995 to 2300 in 2006. As retail banking usually depends on the number branches maintained, their development in Germany will be examined.

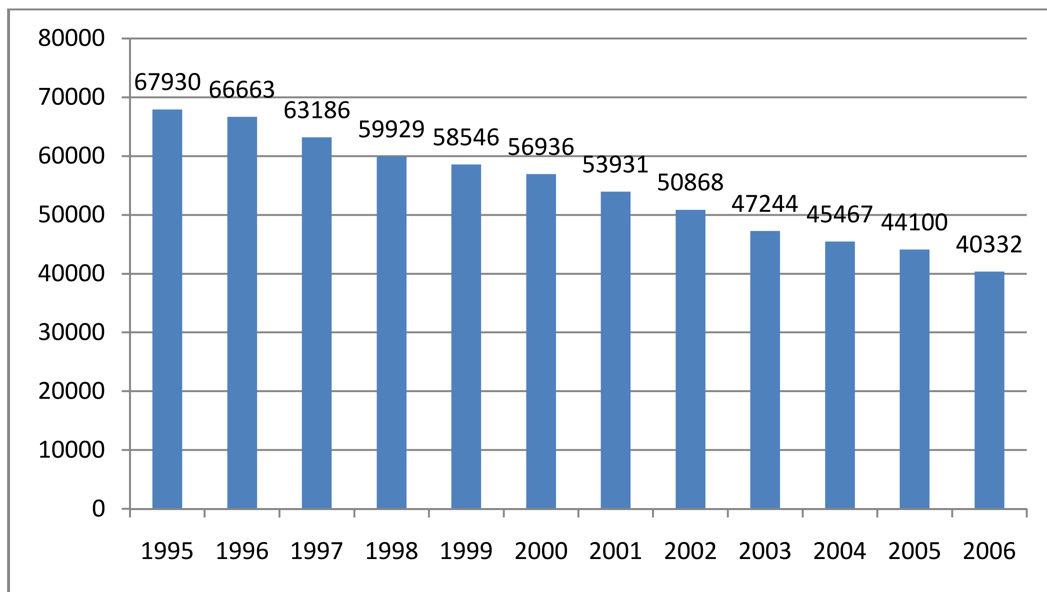

Figure 6: Development of Total Bank Branches in Germany
(own illustration based on Köhler,2008a)

Savings banks and cooperative banks have reduced the number of branches significantly. Public-sector banks (savings banks, state banks etc.) with 18,757 branches and cooperative banks with 16,028 branches in 1998 reduced the number of branches to 14,252 and 12,303 respectively in 2006. Moreover, the number of branches of major commercial banks decreased from 19,055 in 1998 to 8,879 in 2006.

The main cause for the decrease of branches is the high fixed costs, which can not be recouped from low-revenue standard products that can also be distributed through alternative low-cost channels such as the internet.[70]

[70] Köhler and Land (2008)

As a third indicator of industry growth, this paper reflects on the allocation of market share within the retail banking sector in order to indentify trends that may affect overall market growth. This paper will reflect on market share in two major retail banking segments - savings deposits and loans. The German Central Bank classifies the banking market in terms of savings banks, cooperative banks, direct banks and credit banks. The latter include universal banks, which are private commercial banks, branches of foreign banks, regional banks and other private banks.

This section reflects the development of market share regarding short-, medium- and long-term saving accounts and examines the allocation of loans to corporate clients, consumers (consumer loans), private households and self-employed persons.

In the period from 1998 to 2006, the market for medium-term saving deposits with a cancellation period under three months has been dominated by saving banks (53 % market share in 2006) and cooperative banks (29% market share in 2006). In the same period, the market share for long-term saving deposits with a cancellation period above three months has also continuously been dominated by savings banks (65 % market share in 2006) and cooperative banks (24 % market share in 2006). However, with regard to deposits that mature daily, direct banks were able to increase market share from approximately 1.5 % in 1998 to over 15 % in 2006.

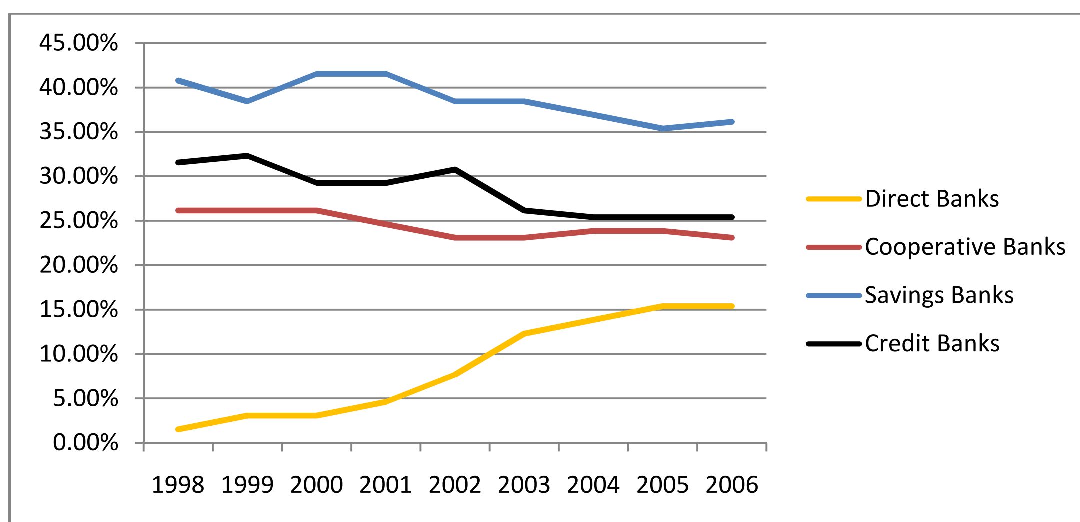

Figure 7: Market share development of saving accounts that mature daily
(own illustration based on Deutsche Bundesbank, 2007)

From 1998 to 2006, market share for loans for corporate clients has been continuously dominated by credit banks (53 % market share in 2006) and savings banks (34 % market share in 2006). However, this data also comprises loans for medium and large corporations, which are not part of the retail banking market. Loans for private households and self-employed persons have predominately been granted by savings banks (39% market share in 2006), credit banks (30 % market share in 2006) and cooperative banks (25 % market share in 2006), though direct banks were able to gain some market share from 0 % in 1998 up to 5 % in 2006. Even more significantly, direct banks were able to gain over 16 % market share in the segment of consumer loans.

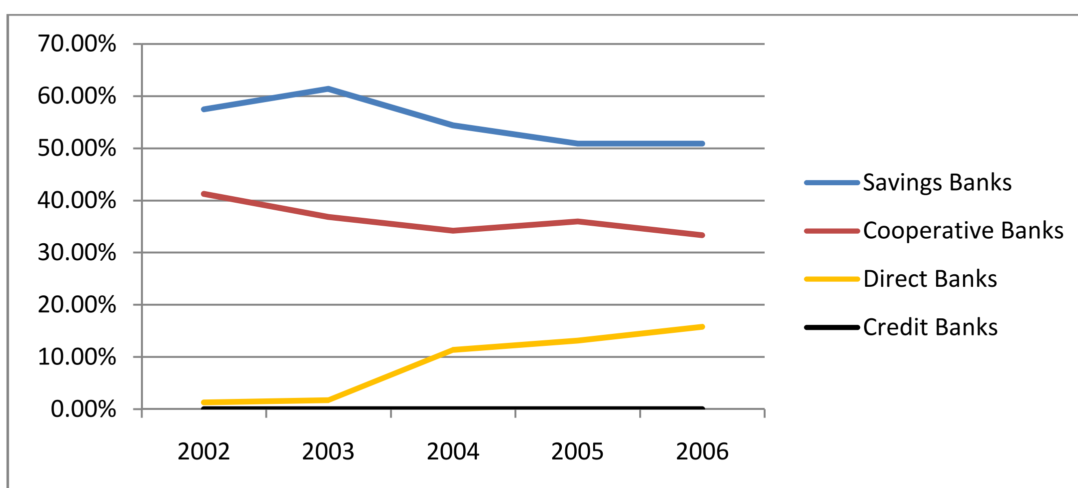

Figure 8: Market share development of consumer loans
(own illustration based on Deutsche Bundesbank, 2007)

Hence, the most significant growth indicator of the retail banking market results from the emergence of direct banks, which were able to gain substantial market share in consumer loans and deposits that mature daily.

In conclusion, the industry growth analysis indentifies the following growth indicators: Firstly, a sharp decrease in the German population in the following decades will reduce growth and increase industry rivalry. Moreover, the demographic change increases the proportion of old people in the population. Secondly, the number of branches in Germany is decreasing due to high fixed costs of branches. In order to be profitable in retail banking, the existing branches must serve a large quantity of customers, which leads to strong competition relative to market share. Thirdly, the development of market share allocation

indicates that only direct banks have experienced significant growth from 1995 to 2006.

Exit barriers: From a perspective of Transaction Costs Economics, one can argue that exit barriers in branch banking are high for market participants as branches and staff are highly specific assets that lose value when used in another situation. To a large extent, these assets are locked into the context of retail banking. Moreover, public-law banks usually have to serve the population, regardless of whether they are profitable or not. In a situation in which a bank continuously experiences losses, staff and branches may be considered as sunk costs and thus economically `irrational´ exit barriers. However, theories suggest that staff and branches are practically valid exit barriers and cause MNCs to stay in a market.[71] The high degree of exit barriers intensifies the strong rivalry among existing competitors.

4.3 Threat of New Entrants

New entrants usually seek to gain market share while applying pressure on prices and costs and thus increasing the investments necessary to compete. An expert survey conducted by the ZEW emphasizes the importance of entry threat to the German retail-banking market: 66.66 % of market experts state that new competitors (e.g foreign banks) have an important or a very important impact on industry rivalry.[72]

In this section the *threat of new entrants* to existing market participants in the German retail banking sector is discussed. In this regard, this section evaluates *legal entry barriers*, *capital requirements*, *the necessity of large scale operations*, *customer switching costs* and *incumbency advantages of existing domestic banks*.

Legal entry barriers are determined by governmental regulations in the German Banking Act (GBA) and are supervised by the Federal Supervisory Authority[73]:

According to section 32 para 1 (1) GBA, companies that intend to pursue commercial banking transactions or financial services in Germany require written

[71] Hill, Hwang and Kim (1990)
[72] Köhler and Lang (2008)
[73] Bundesanstalt für Finanzdienstleistungsaufsicht (2005)

permission from the Federal Financial Supervisory Authority ("Bundesanstalt für Finanzdienstleistungaufsicht"). The execution of banking transactions or financial services also exists when the operator has its headquarters or primary residence abroad but repeatedly targets companies or individuals who have their primary residence in Germany. In order to obtain the permit, several requirements are examined (e.g business plan, qualified management etc).

Companies from third countries which intend to conduct banking transactions and provide financial services in Germany must establish a subsidiary (section 32 para 1 in connection with ection 33 para 1 (6) GBA) or a branch (section 32 para 1 in connection with section 53 GBA) in Germany. Companies from third countries can apply for an exemption according to section 2 para 4 GBA, if the company is supervised utilizing international accounting standards in the home country and the responsible authority works together with the BaFin. According to section 53b GBA, companies of EEA states are allowed to establish branches (section 53b para 2) but are also free to conduct cross-border financial services without a domestic presence (section 53b para 2a). Section 32 para 1 GBA does not apply to business that is motivated by the initiative of the domestic individual or enterprise (so called passive service freedom).

Representations are limited to their representative function and are not allowed to conduct or initiate any banking business.

Capital requirements are low for cross-border lending and and relatively low for representations. With high equity modes such as branches and even more so with subsidiaries, capital requirements are relatively high as capital is required for building a broad network of facilities and offering credit to customers. Capital requirements for direct banks are relatively low compared with those of B&M banks.

The *necessity of large scale operation* is related to the competitive advantage of economies of scale. A company that serves the market in the context of larger quantities benefits from lower cost per unit. In retail banking profit is gained by having a large number of clients. It is expensive to build up these numbers and to establish a distribution network to serve them. This necessity relates directly to the strategy of the bank. An acquisition offers a shortcut to these facilities, although the

costs of integration can be high as well.[74] A MNB may also decide to target only a certain geographical area with certain clients and therefore do not have to enter on a very large scale.

Customer switching costs are different for each individual. In general, customers can easily change their banks and open a deposit account or apply for a loan at another bank. However, they have to compare the different terms for usually small transactions, to evaluate the convenience of having a bank nearby and then to decide to terminate the relationships with their current bank.[75]

Finally, the *incumbency advantages of existing banks* are important entry barriers. In particular, they include established brand reputation, possession of the most favorable geographical locations and market knowledge. Moreover, established banks may already have exclusive contracts with SMEs.[76]

To conclude, legal entry barriers are low and particularly low for banks from the EEA. Capital requirements for entering the market are high, yet as far as equity entry modes are concerned, direct banks require relatively low capital as they distribute their services through low-cost channels. Banks need to attract many customers to be profitable but banks strategy dictates whether or not to entrance should occur on a large scale. Moreover, the incumbency advantages of existing banks constitute important entry barriers.

4.4 Threat of Substitute Products or Services

A substitute in retail banking is a service that offers an attractive trade-off to a bank service or product. As individuals and small firms do not regularly report financial information as do large enterprises, they rely primarily on bank lending. However, there are additional forms of financing in the private equity or dept market.[77]

Many non- and near- banks provide substitute products and services. Near-banks or quasi-banks are suppliers of financial services, but are not classified as credit institutes according to section 1 GBA. Near-banks, such as insurance companies or credit card organizations, however, do provide substitute products or services. Non-

[74] Hughes and MacDonald (2009)
[75] Adams (2002)
[76] Adams (2002)
[77] Xiaoqin and Terada-Hagiwara (2003)

banks, such as department store chains, catalog companies or car producers also provide substitute services.[78] For instance, instead of taking out a loan in order to pay for a product, individuals or small enterprises may decide to take on a leasing contract for a certain asset or small enterprises can obtain a trade credit as well. Individuals may decide on buying products from insurance companies instead of putting money into a bank account.

Another substitute for both direct and B&M banks is the person-to-person (p2p) lending business, a new form of borrowing and lending money that takes place in a web-based market place. In this online platform, borrowers are connected to lenders through an auction-like process in which a lender who bids to provide a loan for the lowest interest rate will be awarded the loan contract with the borrower. A p2p company mediates between private or company borrowers and lenders and also executes transactions between the parties, similar to the role which e-bay plays in the trade of commercial goods.[79] The p2p lending business does not involve traditional banks and thus can offer superior interest rates to borrowers and higher returns for lenders.

4.5 Bargaining Power of Suppliers

When a supplier group is more concentrated than the industry, does not primarily depend on the industry and when the industry faces high switching costs, the supplier group has strong bargaining power and can reduce the profit potential of an industry. In the retail banking market the most relevant suppliers include human resources, suppliers of capital resources and suppliers of information and communication technology (ICT).[80] Highly talented or experienced specialists are strongly canvassed and have strong bargaining power with respect to their salary and working conditions. However, in the aftermath of the financial crisis, many banks are planning a reduction of staff. According to a study of Ernst & Young, every fifth bank intends to decrease staff and only every 10th bank is planning an increase.[81] Given the current situation of the employment market, the bargaining power of employees is relatively low. Suppliers of highly specialized banking ICT

[78] Gabler Wirtschaftslexikon (2010)
[79] Deloitte (2009) p. 12
[80] Büschgen and Börner (2003)
[81] Ernst & Young (2009)

solutions have strong bargaining power, as switching costs for these systems are very high. Moreover, the higher yield requirements of shareholders can be interpreted as supplier power.

4.6 Bargaining Power of Buyers

In retail banking there are many buyers with relatively low transaction volumes, which weakens their bargaining power. However, retail banking services are standardized and buyers can easily find similar services. Switching costs have usually been relatively high for these low volume transactions, but in the age of the internet the market is very transparent and buyers can screen different offerings more easily. This does not necessarily imply that the cheapest banking service will be chosen automatically, as customers also seek a trustworthy brand, especially in times of financial crisis. Moreover, there are other factors that affect the switching cost of the individual such as the location of the branch. Yet, there is a tendency towards the increasing bargaining power of buyers.

This is also substantiated by the ZEW survey: 79.84 % of market experts state that decreasing customer loyalty and increasing price sensibility are important or very important factors with respect to the intensity of competition in the German retail banking sector. A comparison of former and modern retail customers also indicates that the bargaining power of retail banking service users has increased.

Former Retail Customer	Modern Retail Customer
Passive information seeking behavior	Active information seeking behavior
Hardy or little informed	Good to very good know-how
High customer loyality	Increasing willingness to switch
Fixation on the branch	Expects multi-channel banking at all times and places
Little market transparency	High price transparency
Relatively undemanding	Demanding

Figure 9: Comparison of former and modern retail customers
(own illustration based on Swoboda, 2004)

5. Foreign Bank Entry Strategies in Germany

This section illustrates mode choices for foreign bank entry in Germany. Based on the hierarchical model of market entry modes[82], the foreign bank has the choice of equity and non – equity modes of entry. An advantage of the hierarchical model is that it allows comparing between entry modes on different levels. The main difference between equity and non – equity modes is the degree of resource commitment in the foreign country. As classified at the beginning of this thesis, non-equity entry refers to international banking and equity entry refers to multinational banking.

The research question of this thesis considers multinational bank entry modes. International banking, however, is often a first step towards multinational banking. Hence, this thesis will also discuss cross-border lending and alliances as non – equity entry modes. The following figure illustrates a comprehensive view of market entry modes for banks.

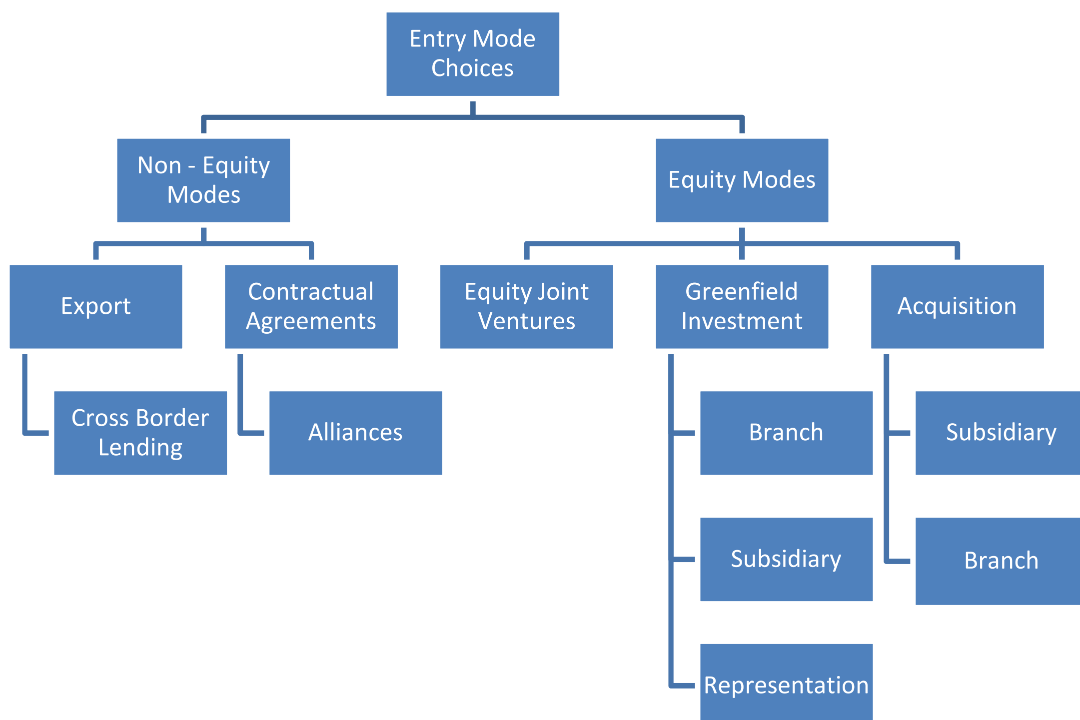

Figure 10: A hierarchical model of entry mode choices for banks
(own illustration based on Pan and Tse, 2000)

[82] Pan and Tse (2000)

The hierarchical model illustrates the various entry mode choices for entering the German retail banking market. The creation of a common European financial market in which banks can integrate freely is a major goal of the European Union.[83] The previous section of this paper indicates that entry barriers are relatively low and that the German market is highly competitive. Hence, the choice of a proper entry mode which is appropriate to the capabilities and the strategy of the bank is even more significant. Therefore, the following section will reflect on the strategic concept governing the choice of entry modes as well as the proliferation of these entry modes in the German retail banking market.

An international bank that is not interested in investing equity in the foreign market, can enter by means of cross-border lending or by forming a non-equity alliance. These non-equity entry modes can help the bank to access niche markets or to exploit locational advantages when the bank is located near the German border.

However, a retail bank, defined in the beginning of this paper, as a bank that *`caters for ordinary individuals and small business´* and that seeks to enter the German market in order to gain significant revenue from deposits and loan business, might have to consider a physical presence in the foreign country.

The analysis considers entry modes that are perceived as international banking: cross-border lending and non-equity strategic alliances. Furthermore, the equity modes JVs and representations will be discussed.

Subsequently, this section compares the market entry of a branch through Greenfield investment with the market entry of a subsidiary by virtue of acquisition, as these modes of entry are the most common in the German retail banking market.

Finally, the following question will be addressed: to what extent do demographic and technical trends favor a direct bank entry mode over a brick and mortar bank approach in Germany?

[83] Fidrmuc and Hainz (2008)

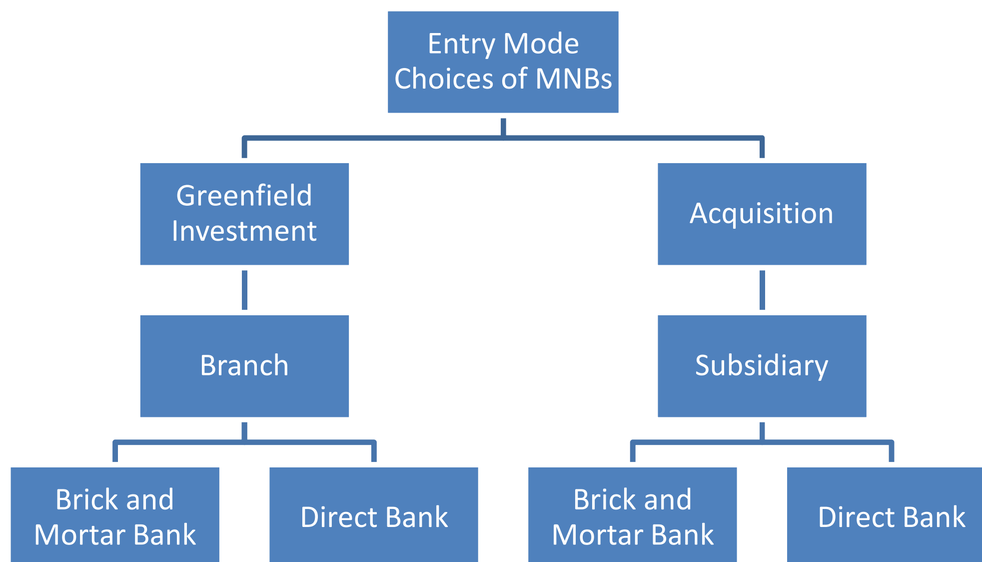

Figure 11: Greenfield vs. acquisition and B&M banks vs. direct banks
(own illustration)

5.1 Non – equity modes: Export – Cross-Border Lending

Cross-border lending is equivalent to the export entry mode and is a simple non-equity strategy to enter a foreign market. A bank which participates in cross-border lending must assess the creditworthiness of the individual borrower as well as the country risk, which involves the possibility that these loans will be impaired by economic or political proceedings in the foreign country.[84] The country risk in Germany is rather low, as it is perceived to have a solid political and economic situation (Country Rating A2) with a stable and a very efficient business environment (Country Rating A1).[85] As a bank will only have limited access to soft information about the creditworthiness of the borrower, the availability of loans usually decreases and the interest on loans usually increases with distance.[86] Soft information for private loans includes the previous experience with the account management of the credit user, environmental facts and a judgment relative to his employment contract.[87] For corporate loans, soft facts may include the market environment, corporate structure, management, a business plan as well as

[84] Hughes and McDonald (2003)
[85] Online: www.trade-safely.com (2009)
[86] Agrawal and Hauswald (2007)
[87] Dizil (2009)

existential risks.[88] Foreign banks may require a cost advantage and should be capable of taking on the higher risk.

A recent study on cross-border lending at the German – Austrian border suggests that German SMEs which are located near a border may use this opportunity to take out a competitive loan from a bank that is located next to the border but in a foreign country, due to the fact that soft information about the SME is easier to transfer with little physical and functional distance.[89] The study also suggests that this advantage will be maintained for a distance up to 100 kilometers and that in the recent past a phenomenon occurred in that cross-border lending has been only the first step towards an FDI. In this regard, another study on German banks that operate abroad examined the relationship between FDI and the provision of financial services without affiliates in the foreign market.[90] As many German banks provide financial services abroad without any affiliates, this may imply that cross-border financial services are a substitutes to FDI. However, the study concludes that more cross-border financial services are provided to countries in which foreign affiliate exits than when this is not the case. Therefore, FDI and the provision of cross- border financial services abroad complement rather that substitute for or exclude each other.

5. 2 Non – equity modes: Contractual Agreements – Alliance

A strategic alliance is a market entry mode in which the MNB enters into medium- or long-term co-operative contractual agreements with enterprises (vertical alliance) or banks (horizontal alliance) in the foreign country. The partners in the alliance may pursue common or different goals. In the non-equity alliance, no new entity is founded (Joint Venture) and the contractual agreements are not secured by any capital participations (equity alliance).[91] An example of a strategic non-equity alliance is the cooperation between the BHW Bank AG and the automobile club ACE, which exclusively offers motorcar financing and the investment products of

[88] Reichling, Beinert and Henne (2005)
[89] Fidrmuc and Hainz (2008)
[90] Buch and Lipponer (2004)
[91] Schilke, Oliver (2007)

the bank to its 550.000 members.[92] Alliances offer a broad variety of starting points, including not only strategic alliances but also models of in- and outsourcing in which other enterprises are utilized within the value-creation chain.[93] The advantages and disadvantages of non-equity strategic alliances are similar to those of joint ventures and will be discussed in the subsequent section. The main advantage involves the sharing of risks and costs while utilizing the local partner`s knowledge and networks in the foreign country. In contrast to a JV, a non-equity alliance allows the MNB to gain access to resources and capabilities with very low resource and capital commitment in the foreign country. However, a bank can hardly penetrate the highly competitive German retail banking market in the long-run with such a low resource commitment and presence in the market.

5.3 Equity Joint Ventures: Joint Venture (JV)

An equity joint venture is an entry mode in which both partners contribute capital to a mutually owned business with a certain degree of independent management and a share of profit and losses.[94] When expanding abroad, depending on the particular market a joint venture can help to save costs, share risks, access new technology, expand the customer base and grow outside the core business lines. JVs can reduce environmental uncertainty due to the local partner's knowledge and therefore save ex-ante information searching costs. In contrast to non-equity alliances, a JV is structured more hierarchically and therefore reduces coordination and information processing costs.[95] The problems of joint ventures may arise from a shared and therefore perhaps slow and inefficient management, communication problems, poorly designed contracts or clash of cultures. A JV can be formed between banks and other financial institution or across industries.

Bank of Ireland, for example, created a JV with Post Office Ltd offering financial services within the 16,900 branches retail network of the Post Office Ltd. This branch network was stronger that all UK banks and building societies branches put together. Mike Soden, the former Group Chief Executive of Bank of Ireland,

[92] BHW Bank AG (2004)
[93] Banken+Partner (200x)
[94] Hewitt (1997)
[95] Ang and Michailova (2008)

commented on the JV agreement: `This is an excellent opportunity for Bank of Ireland to extend its reach in the UK a market that is central to our strategy. This joint venture, combined with our existing personal and business banking operations in the UK, gives Bank of Ireland a unique level of access to the UK retail financial services market.`[96]

Another example is the Hyundai-Kia Capital GmbH, a JV between the Spanish Santander Consumer Bank and the South-Korean automobile group Hyundai-Kia, which provides auto financing in Germany. The JV in Germany is also the entry mode for further expansion of the two partners in Europe. Javier San Felix, executive vice president of Santander, said: `We are delighted that we can offer Kia our market-leading products and services to support its future growth in Germany. We expect this partnership to develop into a larger partnership with Hyundai-Kia Group in other Western European markets.`[97]

5.4 Equity Modes: Representation

A representation is a limited yet easy means to establish a first step into a foreign market.[98] It involves the utilization of a bank agent, mostly in form of only one office, which pursues no banking transactions but initiates contacts to potential customers and delivers information.

For instance, the International Bank of Azerbaijan has opened representation offices in New York, Dubai, Luxembourg, London and Frankfurt. The overall goal of the bank`s expansion strategy is to analyze the foreign markets and to find new opportunities for business expansion in the respective states.[99]

In Germany, the handling of representation is regulated in the German Banking Act. According to section 53 (a) GBA, a foreign credit institute may establish or continue to operate a representation in Germany if it is authorized to pursue banking transactions or to provide financial services in the country in which it has its head office. Furthermore, the institute must notify its intention to establish a

[96] Bank of Ireland Homepage (2003)
[97] Jae-Won (2010)
[98] Naaborg (2005)
[99] International Bank of Azerbaijan Homepage (2010)

representation and the execution of said intention to the Federal Financial Supervisory Authority and the German Central Bank immediately.

Due to the legal constraints regarding economic activities for representation and the introduction of the Euro currency, the number of representations in Germany has fallen sharply from 250 in 1993 to 77 in 2008.[100]

A representation is not allowed to undertake banking activities but it can observe and study the market. Although resource and capital commitment is relatively low compared to other equity entry modes, transferring business to the parent house can be time and cost consuming. Yet, a representation can be easily transformed into a branch or a subsidiary.[101] In summary, a representation is a low-equity entry mode, with low resource commitment but also limited possibilities to penetrate the market. It is often employed as a temporary solution until the establishment of a branch or a subsidiary is reasonable from an economic point of view.[102] A high percentage of representations in Germany are established in order to prepare a market entry by branch or subsidiary after a period of market observation.[103]

5.5 Greenfield - Branch Entry vs. Acquisition – Subsidiary Entry

As in the German banking market branches are usually established by means of Greenfield investment and subsidiaries usually originate from an acquisition, this section addresses the question of what affects the entry mode decision between branch entry by Greenfield investment or subsidiary entry by acquisition.

The proliferation of foreign branches in Germany is as follows: In 2007 119 foreign branches and 86 foreign subsidiaries were present in Germany. Though many foreign banks have been in this market for many years, approximately 11 % of the foreign banks in Germany focus on retail banking, whereas 89% focus on corporate clients. This is mainly explained by the defensive expansion theory (see

[100] Vob Frieling (2002); Association of Foreign Banks in Germany (2008)
[101] Epperlein (2005)
[102] Büschgen (1972)
[103] Von Frieling (2002)

also section 4.3 Strategy of Defensive Expansion).[104] As legal entry barriers for banks from the European Economic Area are low since the EU banking coordination directive of 1992 (see also section 3. 5 Threat of Entry), the number of branches from the EEA has increased strongly from 34 branches in 1995 to 100 branches in 2007, whereas in the same period the number of branches from third countries decreased from 34 to 19.[105]

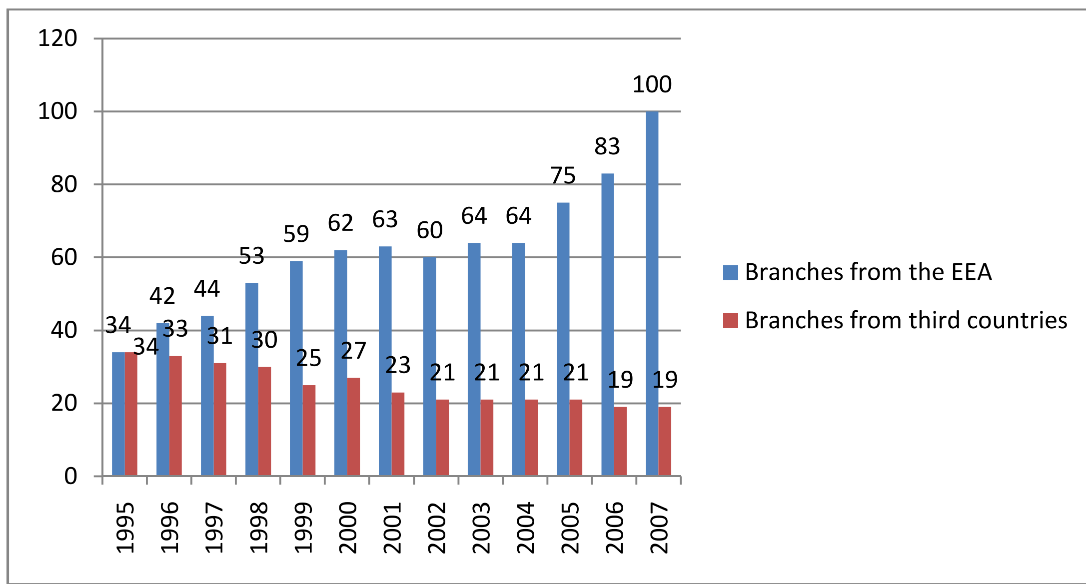

Figure 12: Development of foreign MNBs branches in Germany
(own illustration based on Köhler, 2008)

Branches are legally dependent offices of the parent company. Thus, the branch and the parent company is the same legal entity.[106] A branch directly benefits from the reputation of the parent and compared to the establishment of a subsidiary, capital requirements are relatively low.[107] Furthermore, a single corporate entity has the advantage of facilitating economies of scale.[108] However, all liabilities of the branch are liabilities of the parent as well. The flexibility in management is lower than in the independent subsidiary and the long-term success of the branch depends on the capital and personnel resources of the parent. It is less capital intensive to establish a branch than to acquire or to establish a subsidiary from scratch, as there are no costs for incorporation, no costs for annual reporting, fewer costs for administration and no costs of employing a board of directors. Branches

[104] Köhler (2008) p.5
[105] Köhler and Lang (2008a)
[106] Borchgrevink and Moe (2004)
[107] Büschgen (1972)
[108] Dermine (2002)

are often used to target corporate clients by provision of services with regard to foreign exchange or money market trading. Yet, as a branch is a legal part of the parent bank, careful supervision by the parent is required as unauthorized trading could cause the bankruptcy of the parent.[109]

MNBs which enter through Greenfield investment traditionally serve large international corporations. As foreign branches are the same legal entity as the parent bank, they are also more influenced by the home country conditions of their parent bank than subsidiaries.[110] A Greenfield investment allows the MNB to target specific market segments which might not have been possible through an acquisition, as the MNB would also acquire customer profiles of the foreign bank. Dealing with existing clientele may not be consistent with the strategic positioning of the parent bank and would also be costly to adjust.[111]

In contrast to branches, subsidiary banks are separate and independent legal entities which are subject to the supervision in the operating country, whereas the home country is responsible for the supervision of the parent company and the group.[112] As mentioned in the beginning of this section, they are often created through a cross-border acquisition and are subject to the supervision of the BaFin.[113]

Foreign subsidiaries in Germany have developed as follows: As MNBs from third countries do not benefit from the low European governmental entry barriers for branches, they usually prefer a market entry through a legally independent subsidiary. Hence, there were 43 subsidiaries and only 19 branches from third countries in Germany in 2007. Due to low governmental entry barriers for branch entry within the European Union, there are only 40 subsidiaries of EEA banks compared to 100 branches in 2007.

[109] Thi, N. V. and Vencappa, D.(2008) p.8
[110] Havrylchyk, O. and Jurzyk (2006) p. 3
[111] Thi, N. V. and Vencappa, D.(2008) p.8
[112] Borchgrevink and Moe (2004)
[113] Köhler (2008)

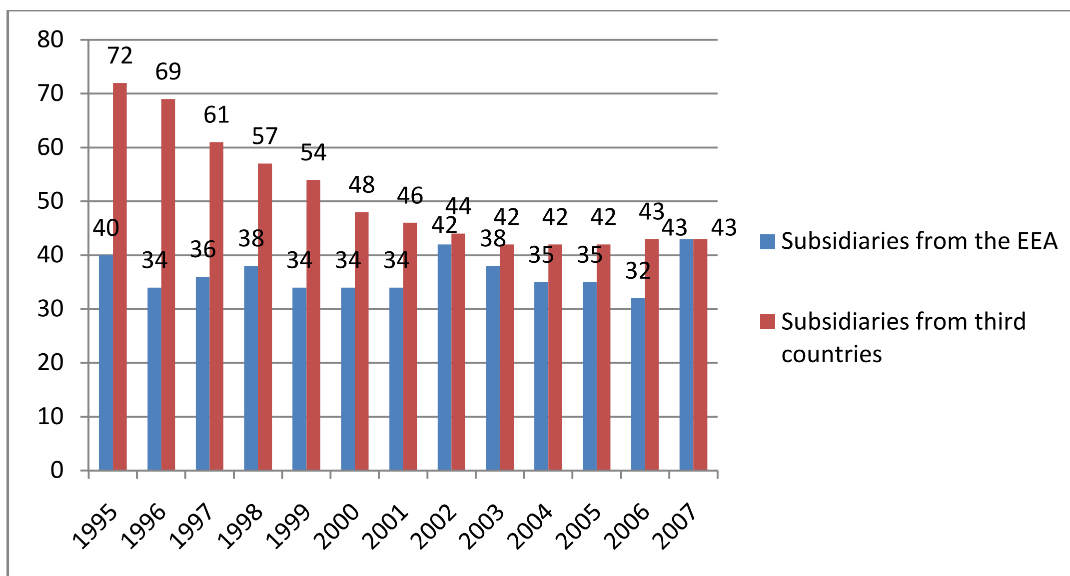

Figure 13: Development of foreign MNBs subsidiaries in Germany
(own illustration based on Köhler, 2008)

The subsidiary structure has the advantage of limiting the parent bank`s exposure to the subsidiary bank and of establishing a local connection in the foreign market.[114] However, as a subsidiary is an independent legal entity, it may fail, even though the parent is solvent. In contrast to branches, its lending capabilities are limited to its own capital resources. Hence, subsidiaries are less appropriate for corporate lending and trading business but more appropriate for retail banking.[115]

There are several factors that may motivate an MNB to acquire a foreign bank, compared to entering by means of Greenfield investment. One motivation includes the access to local market knowledge and important resources. In the case of retail banking, a significant branch network is often required and it can be very costly to establish this by de novo investment compared to the acquisition of a bank which already has this network. One strategy would be to acquire a bank which performs poorly, as these banks may provide a relatively low-cost entry option. The MNB would then attempt to improve the performance of the acquired bank. An alternative strategy would be to acquire a bank and to exploit its market knowledge and cost advantages.[116]

[114] Dermine (2002)
[115] Thi, N. V. and Vencappa, D.(2008) p.8
[116] Thi, N. V. and Vencappa, D.(2008*) p.7*

One field of economic literature concerned with the entry mode choice of banks indicates that domestic banks have a knowledge advantage relative to soft information on the creditworthiness of borrowers. A recent working paper on entry choice for banks argues that foreign banks face a trade-off between the extent of market entry costs and their disadvantage regarding soft information on the customers and their market knowledge. Hence, banks that are inefficient in screening borrowers do not expand abroad, whereas with increasing efficiency, cross-border lending becomes the optimal option. As soon as the enhanced market knowledge in the case of Greenfield investment compared to cross-border lending compensates for the larger fixed costs of entry, Greenfield Investment becomes the optimal entry mode. If the screening technology is high enough to drive down the acquisition price, an acquisition becomes feasible.[117]

5.6 Direct Bank vs. Brick & Mortar Bank

Modern information technology has revolutionized the banking market and given rise to web-based services offered by both traditional branch banks and banks that are solely based on direct distribution channels. In this section, the entry mode choice is simplified and limited to traditional brick & mortar and direct banks. If one excludes multi-channel banks, the impact of industry trends on direct and B&M banks can be analyzed very precisely.

Consumers utilize direct banking services either as a substitute for or a complement to traditional brick and mortar bank accounts. Consumers value direct banking for two reasons - added convenience and price advantage. The concept of a direct bank is to provide normal banking transactions in a fast and inexpensive manner with important yet uncomplicated products and account services. Furthermore, direct banks have price advantages due to more efficient processing of banking transactions. Customers are expected to be informed and conduct banking transactions themselves, which they can perform 24 hours a day and 7 days a week, in contrast to branch banks which are open only during normal office hours.[118] It is very convenient for customers to be able to conduct banking transactions from

[117] Lehner (2008)
[118] Swoboda (2000)

home, from work, at any place via mobile phone and at any time. German direct bank leader ING Diba compares bank branches to telephone boxes in the age of mobile phones – old, uncomfortable, and superfluous[119]. The incentive of speed is supported by the development of a comprehensive access to fast broadband internet in Germany.

With the brick & mortar branch concept a, the majority of customers use a branch for standard transactions such as money transfers or deposits an such existing customer contact can rarely be exploited for the cross-selling of other financial products. Furthermore, back and front office activities are often not clearly separated and employees have to divide their time evenly, independent of the potential strengths of a customer.[120]

From a perspective of transaction cost economics, the direct banking business model has a significant advantage over B&M banks. The European central bank has calculated that a transaction by phone is up to 60 percent and one on the internet is up to 99 percent cheaper than in the branch.[121] In the USA, for instance, bank transaction costs are approximately 1.07 US Dollar for a branch transaction, 0.27 US Dollar for an ATM transaction and under 0.01 US Dollar for transactions, conducted via the internet.[122] The direct bank entry also involves lower fixed costs by avoiding the establishment of a branch network and lower personnel costs by being able to employ a less qualified staff.[123]

However, from a customer perspective direct banks also have immense disadvantages compared to B&M banks in terms of convenience. In particular, B&M banks have no delay in money transfers, offer face-to-face customer service and quick and easy access to money free of charge at ATMs. Furthermore, many customers may have difficulties in learning the technical aspects of online banking. They also fear their exposure in web-based technology with its privacy and data

[119] Reuter (2003)
[120] Petzel (2005) p. 179
[121] Reuter (2003)
[122] Sheer (1999)
[123] Keuper (2002) p. 354

abuse concerns. Moreover, some customers do not have a distinctive central interest in financial matters and are rather person oriented[124].

5.6.1 Demographic Trends

In the structure analysis of the German retail banking market, this thesis describes future demographic change in German society: the number of older people and the proportion of older people of the total population will increase substantially. In particular, the percentage of people aged 80 and older will increase from 5 to 14 % in the next 50 years. This section analyses its implications for the establishment of direct banks compared to brick and mortar banks in the retail banking market.

Initially, one has to consider the fact that different life phases require different bank services. For instance, the demand for loans is highest from the age of 25 to 35 years because many investments are necessary to establish a means to earn a living. Savings volume reaches its height at the age of 55. On the product level the most important criterion for elderly people involves the security factor. The tendency to risky or speculative investments decreases with age.[125] Hence, traditional retail banking products such as saving accounts or call money accounts will become increasingly important as compared with riskier investment products.

Some characteristics of elderly people indicate that the direct bank business model has tremendous disadvantages compared with B&M banking. Compared to the rest of the population, elderly people are far less willing to accept changes in favor of better terms. In a survey of the elderly, 41 % indicate that they will not change their bank even if a competitor offers better terms. Criteria such as trust in established structures, recognition of the staff and friendliness are substantially more important than yield. However, bank loyalty decreases at higher income levels.[126]As elderly people value familiar structures and are not as attracted to better terms as young people, the direct bank strategy of price leadership is not as effective with this group as with other segments of the population. Furthermore, a study of the market research company Gfk and the chemist shop magazine "Senioren Ratgeber" finds that the elderly resist the use of both online banking and ATMs. 87 percent of the

[124] Petzel (2005) p. 179
[125] Forschungsgesellschaft für Gerontologie e. V (2006) p.5-6
[126] Forschungsgesellschaft für Gerontologie e. V (2006) p.6

60-year-olds highly value individual consultation and personal contact when undertaking banking transactions. 90 percent of the senior citizens in the study hardly use the possibility of online banking. Instead, almost half (48.5%) of the people from 60 to 69 years of age and 68.2 percent of those over 70 years favor a personal contact with bank employees. A third of the people between the ages of 60 and 69 years and nearly half of the people of over70 even favor a cash withdrawal from a branch employee over the use of an ATM.[127]

In the market structure analysis, this paper describes the reduction of branch networks in Germany. The elderly and especially those over 70 years of age are often very limited in their mobility. If they are not interested in the direct banking model, they highly regard a local bank even if its terms are less attractive than online competitors. Furthermore, house visits from bank advisors are being considered. A BASGO survey the elderly people indicates that half of the respondents would appreciate this option whereas the other half opposes the idea of house visits.[128]

Demographic change should affect the entry strategy of MNBs in that the current phenomenon of branch network reduction indicates a shift in consumer preferences and the alleged superiority web-based business models could be inefficient in the long-run. Although branches have been primarily considered as cost factors in the last decade, the demographic change suggest that their importance as distribution channels and consultancy centers may increase in future. Banks have to consider the fact that elderly customers are increasingly moving into traditional holiday areas, metropolitan regions as well as in the vicinity of their relatives. The proximity of banks becomes increasingly important to the elderly and should influence the establishment of branch networks in regions in which elderly populations settle.[129]

However, demographical changes may also benefit a direct bank business model as compared with B&M banks. A Generation Y person, the future target group born between 1980 and 2000 which is composed of the children of `baby boomers` , a generation Z and a generation alpha, which refers to babies born after 2010, will be

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[127] Horizont (2009)
[128] Forschungsgesellschaft für Gerontologie e. V (2006) p.18
[129] Schmitz (2007) p. 11-12

very confident in using communication tools, digital technology and the internet. Generation Y consumers are described as `well-connected, multi-channel buyers who have high expectations for convenience, information and service`[130]. When these generations age, they will have completely different preferences from current senior citizens. MNBs need to analyze these preferences to weigh the cost and convenience advantages of direct distribution channels against the cross-selling and convenience advantages of B&M distribution channels.

5.6.2 Technological Trends

As mentioned in the introduction of this thesis, the processing of bank transactions and customer services is becoming increasingly independent of the branch distribution channel, and the adoption of new technologies substantially affects the allocation of retail banking services. The progress of technological evolution and the implementation of virtual banks which offer chat and video-consultancy with bank employees or virtual-consultants (so called avatars)[131] may have an immense impact on the banking industry. In addition, many other tangible technological innovations are already emerging and will shape the dynamics of the retail banking industry in the near future.

For instance, in the USA payments processed at branches have already decreased due to the use of remote deposit capture (RDC). RDC refers to a service that allows users to scan checks onto a computer and to transmit the image to a bank. This can already be done from a common scanner at home or at the office and even mobile phone cameras are being tested for this application.[132]

Not internet banking per se but the evolution of the technological means to facilitate the practical applicability of internet banking will provide impetus towards increasing demand in these alternative distribution channels. The acceptance and use of these banking channels complement the direct banking business model. For instance, the further development of mobile banking will extend the convenience advantages of direct banking by allowing customers to process bank operations in every location.

[130] Deloitte (2010)
[131] Keck und Hanh (2006) p. 193
[132] Deloitte (2010)

Mobile banking is either browser-, message- or client-based. With browser-based applications, consumers can connect to the internet via wap, i-mode or xHTML and process transactions on the website of the bank. Message-based applications (e.g short – message – service banking) allow functions such as viewing of the current account status, deposits or transactions, notifications on account overdraft, etc. Individual functions can be set in the internet, allowing for personalized alarms and notifications. Client-based applications utilize specific banking software that is installed on the mobile phone. For these applications mobile phones require a specific amount of storage capacity and the user can process transactions offline and only need to connect to the internet in order to execute.[133]

The first attempt of banks to launch mobile banking hardly attracted attention and only few customers used this service. Usability was poor, transfer speed was slow and costs were relatively high. Nowadays, general interest in mobile Banking is still rather low. According to a study by Forrester Research, only 4% of Germans with internet access used mobile banking in 2007.[134] However, national and international studies indicate that mobile banking is increasingly sparking interest. For instance, a study carried out on behalf of Sybase 365 summarizes the evaluation of 92 leading banks - 32 European banks, 30 US banks and 30 banks from the Asia Pacific region. The results show that 66 percent of the banks polled see mobile banking to be an excellent possibility for extending present customer service. 53 percent of the US banks planed to offer mobile banking services within two years. A consumer survey by Sybase also underscores this rising trend. 33 percent of the bank customers wish to process financial matters apart from a fixed location.[135]

The reasons for this tendency can be attributed to three major developments. Firstly, due to globalization and other business developments, business people are increasingly expected to be mobile and they often have to make use of mobile services. By virtue of their financial capabilities, they are a very important target group for banks. They also represent a group which would most probably be willing to pay for convenient mobile banking services. Secondly, technical

[133] Dilg, Friedrichsen and Przyklenk (2004)
[134] Krohn (2009)
[135] Sybase 365 (2008)

evolution results in improved final devices which are more secure and quicker in data transfer. Improved usability and reduced costs are major incentives for mobile banking. Nowadays, modern mobile phones have more user friendly displays, are faster and do have a web browser. The improvement of these features has resulted in higher customer acceptance. Thirdly, demographic changes have resulted in an increasing number of internet and technology familiar employees in business entry-levels but also in more responsible business positions. As this target group is growing in number and in financial capability, banks are increasingly willing to exploit this new distribution channel.[136]

Banks that offer mobile banking benefit from lower transaction costs, as they do not have to effect transactions in branches. However, whether transactions can be directly shifted from the B&M branch to the mobile phone is questionable. Customers that already use online-banking will more likely be the first to use mobile banking.[137] Hence, transaction costs will only be reduced if mobile banking attracts new customers from traditional B&M banks.

Mobile banking will eventually become standard in the retail banking market. Banks that do not offer mobile services will lose customers to other banks that do. In summary, technological progress, exemplified in mobile banking or remote control devices, provides additional benefits for the direct bank business model and will allow customers to substitute the branch channel for standard banking operations.

[136] Tiwari and Buse (2006) ; Frohn (2009)
[137] Strohkark (2008)

6. Case Study: ING-DiBa

The Dutch multinational ING Group entered the German retail banking market through acquisition and became a market leader within a few years. In Germany ING–DiBa offers direct banking services only, whereas in other countries the bank employs a wide network of branches. Although more and more direct banks attract customers with high interest call money accounts and other attractive terms, ING was the first direct bank to penetrate the market with its innovative and comprehensive exploitation of direct distribution channels. In the SWOT and the Marketing Mix framework, this case study exemplifies a successful implementation of the direct bank business model as a means of entering the German retail banking market.

6.1 Corporate Profile: ING Group

ING Group is a Dutch financial institution with its headquarters in Amsterdam. It was founded in 1990 through the merger of the postal bank NMB with the biggest Dutch insurance enterprise, the National Netherlands. The MNB is represented in more than 40 countries, has more than 125,000 employees and serves more than 85 million customers worldwide. With a market value of EUR 26.4 billion, ING is the 19th largest bank in Europe. With its business line ING-Direct, the banks offers services over the internet by phone, ATM or mail in Canada, Spain, Australia, France, the US, Italy, Germany, the UK and Austria. Their products include saving accounts, mortgages, payment accounts, investment products and consumer lending.[138]

6.2 ING Group`s Market Entry and Market Penetration in Germany

ING Group entered the German Retail Banking Market through a multi-step acquisition of the `General German Direct Bank`. Today`s ING-DiBa AG is a wholly owned subsidiary of ING Groep N.V .

The General German Direct Bank was founded in 1965 under the name BSV `Bank für Sparanlagen und Vermögensbildung´. After a strategic new adjustment in 1992,

[138] ING (2010)

the bank provided direct bank accounts via T-Online in 1993. One year later the name was changed to `Gerneral German Direct Bank` (Allgemeine Deutsche Direktbank).

In 1998, ING Group acquired the first 49% of the shares in the Allgemeine Deutsche Direktbank. Shortly thereafter, the bank appeared only under the name of DiBa (for direct bank) in the market. In 2003, the ING Group acquired the Entrium Direct Bankers AG, Germany`s second largest direct bank with 965,000 clients, as well as 100% of the DiBa shares.

In 2004 the end of the technical and organizational merger of DiBa and Entrium occurred with the simultaneous introduction of the new logo "ING-DiBa". In 2005, finally, the bank was renamed ING-DiBa AG.[139]

In contrast to the follow-the-customer hypothesis, which holds true for many MNBs that have entered the German market, the ambitious expansion of the ING Group is regarded as the result of a distinctive growth urge, as increased market share was no longer possible in the Netherlands.[140]

ING-DiBa was able to penetrate the market and developed from a small niche supplier to one of the leading retail banks in Germany. It increased its customer base from only 800,000 in 2001[141] to 6.5 million in 2010.The balance sheet total increased from 7.76 billion in 2001to 87.7 billion at the end of 2009. In the same period the number of employees increased from 422 to 2.750 and the amount of account deposits increased from 6.3 million to 75.3 million.[142]

6.3 SWOT Analysis

The SWOT analysis is an assessment of enterprise-internal strengths and weaknesses in connection with enterprise-external chances and risks. SWOT (analysis of Strengths, Weaknesses, Opportunities and Threats) summarizes the essential results of the analysis of the internal abilities of the enterprise (strengths and weaknesses) and the analysis of the external factors of influence (opportunities and threats). Strengths and weaknesses are considered relative to those of

[139] ING-DiBa (2010)
[140] Modern-Banking (2003)
[141] Tellings (2009)
[142] ING-Diba (2003); ING-DiBa (2009)

competitors. They should be valued by customers and have an impact on customer satisfaction.[143] The SWOT analysis combines the market and the resource based view, in that it considers market potential as well as enterprise-specific resources and capabilities.[144]

Figure 14: SWOT Analysis
(Own illustration)

The model is a means to evaluate the overall situation of an enterprise and in this thesis it will be employed to structure previous analysis. The strengths and weaknesses of an enterprise are thereby confronted with the enterprise-external chances and risks.

The SWOT analysis provides information as to what extent the enterprise-internal strengths can be used for seizing market opportunities or avoiding market risks. The SWOT analysis also restricts strategic planning for commercial units, because market opportunities should not be exhausted if they face enterprise-internal weaknesses.

One advantage of the SWOT analysis is that it is a simple way of summarizing a potentially complex analysis in the context of a well-arranged structure and a high degree of practicability. Furthermore, it reflects the overall situation of an enterprise. However, the model is limited as far as the time difference of the data is concerned., The internal analysis refers to current data, whereas the external

[143] Jobber (2007)
[144] Reinecke and Janz (2007)

analysis is often relates to future developments. Moreover, it is often difficult to collect and quantify data.[145]

6.4 ING-DiBa: SWOT Analysis

In 2003 DiBa acquired the Entrium Bankers AG and the ING Group acquired the remaining 30% shares of DiBa. These acquisitions constitute the starting point for the SWOT analysis of ING-DiBa.

6.4.1 Strengths

With a strong finance group in the background, ING–DiBa profits from its parent reputation and the international experience within the ING Group. Yet, as a subsidiary ING-DiBa was already independent from its parent and could pursue its own strategic objectives as long as it achieved its target requirements. These included attaining an 18.5 ´Risk Adjusted Return On Capital` (RAROC), which depicts the relation between risk and return in the banking business.[146]

With the early ´partnership` and later acquisition of the first direct bank in Germany, BSV `Bank für Sparanlagen und Vermögensbildung´, ING had a promising starting position in this sector.

As ING-DiBa does not operate branches, it save the costs which result from branch banks. Its model is to transmit this advantage to the customers in the form of high credit interest, favorable loans and toll-free services. The direct banking business model offers a new distribution channel with new marketing possibilities and reduced costs, which allows for attractive conditions in order to attract new customers.[147]

6.4.2 Weaknesses

ING-DiBa AG`s business model also has some weaknesses. The costs for maintaining internet service and call centers have to be considered and the lack of direct communication prevents cross – selling opportunities and leads to lower

[145] Kerth and Asum (2008) p.183
[146] ING (2004), p. 18
[147] El-Bastaweisy (2007)

customer retention.[148] In contrast to branch banks, ING can not solve all the financial problems of their customers and provide more complex consultancy. In addition, it can not charge premium prices for better services and consultancy.[149] ING relies on direct communication methods, but many customers perceive transaction activities via the internet or the telephone as insecure and have privacy concerns. Many customers prefer face to face consultancy and a broader range of financial products than those offered by ING-DiBa AG.

6.4.3 Opportunities

With a strong finance group in the background ING–DiBa may be able to grow further through acquisition of German banks. Furthermore, internet banking may become more acceptable through improvements in technology and the wider acceptance and use of economic commerce (e.g Amazon). In 1999 experts expected a large growth in internet banking. Important indicators of this growth involved competitive pressure on cost reduction and revenue enhancement, cost efficiency as compared to branch banking, a wider geographical reach and improved marketing opportunities.[150]

The increase in internet availability also complemented direct retail banks. The number of private German households with internet access increased from 43 % in 2002 to 69% in 2008.[151] The burst of the dot-com bubble may have increased the interest of customers in more secure investment forms.

6.4.4 Threats

As capital requirements are low for direct banking, new entrants from abroad or existing banks can adapt parts of this business model easily. This may lead to increased competition in this market segment and reduce overall profitability. Switching costs for direct bank customers are low, as the internet is transparent and customers may not have such strong loyalty to direct banks as compared with branch banks. In addition customers are also become increasingly sophisticated.

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[148] El-Bastaweisy (2007)
[149] Swoboda (2000)
[150] OCC Publications (1999)
[151] Czajka and Mohr (2008)

This may further intensify competition on prices and reduce the profitability of the industry.

Furthermore, the security concerns of customers and the accompanied reputational loss for direct banking may arise through online fraud such as `phishing`, whereby hackers attempt to steal passwords and conduct transactions through the clients` online account. A bankruptcy or the security failure of a competing direct bank would reduce confidence in the direct bank business model as compared with traditional branch banks.

6.5 The Service Marketing Mix

The marketing mix is a conceptual framework that helps enterprises to structure their approach to the market. The original marketing mix model was first introduced by the American author Jerome McCarthy in 1960. It consists of four elements: product, price, promotion and place.[152] It is a combination of marketing instruments which are utilized by an enterprise in order to achieve its marketing goals in the target market.

Among others, Booms and Bitner criticized that the `4Ps` works better for the product than for the service industry and therefore they added the elements people, process and physical evidence.[153]

The ´7Ps` model is called the extended or the service marketing mix. As financial services are intangible, perishable, inseperable in production and consumption, and vary greatly in quality as they depend on the people who deliver the service, the extended marketing mix may be more adequate than the `4Ps`model to address central elements in marketing decision-making for financial services.[154]

[152] Jobber (2007)
[153] Lancaster and Robber (2005)
[154] Ennew and Waite (2007) p.176

Figure 15: Service Marketing Mix

(own illustration)

The *product* component refers to the decision of which services and products to offer and to match them to the target market.[155] The weaknesses of the product or service can hardly be compensated through other elements of the marketing mix.

The *price* is a key element of the marketing mix as it indicates the value of the service and is closely related to its profitability. Pricing is crucial as it must be both competitive and profitable.

Place refers to decisions concerning the distribution channels, for instance branches or the internet. For different target segments different distribution channels may create a competitive advantage.

Promotion refers to the process of communicating the benefits of the service or product to the customers. Product or service promotion determines how an enterprise draws the attention of the customers to a product or service and with which means and arguments customers are persuaded to effect a purchase.[156]

[155] Jobber (2007)
[156] SDI – Research (2010)

Process refers to the design of the service process and how services are delivered. It includes a coordination of all marketing mix elements to advance interaction quality as well as in-time service delivery.[157]

People include customers, employees and other stakeholders. Here, for instance, qualification needs for employees, staff and people in the distribution chain are considered.[158] The staff may help to build trust and confidence in the intangible service.[159]

Physical evidence refers to symbols such as buildings or uniforms which characterize the quality of the service. As services are intangible and difficult to evaluate, physical evidence in the service sectors help customers to see what they are buying by adding substance to the service concept. For instance, physical evidence may include the provision of brochures or simply the appearance of employees.[160]

6.6 ING DiBa: Marketing Mix (7Ps)

Product: ING-DiBa offers its customers a few standardized core products at attractive terms. After the acquisition of Entrium, ING-DiBa decided to choose a "best-of" product selection[161], resulting in a slim product line of which the most marketed product is the call money account "Extra Konto". The `Extra Konto` call money account is a simple and cheap product , ideal for attracting many customers in a short time and is a basis for cross-selling other products such as mortgaging, brokerage, credit products and other financial services. The focus has been to offer simple and transparent products.[162] In 2003, these transparent products, such as the `Extra Konto`, appeared especially attractive because many investors preferred risk-free investment over high yields after the burst of the stock market bubble.[163] The group´s product politics is based on simple and plain products, including all products which an average private customer needs. Since 2001 the portfolio of

[157] Botten and McManus (1999) p.57
[158] SDI – Research (2010)
[159] Ennew and Waite (2007) p.177
[160] Botten and McManus (1999) p.56
[161] ING (2003)
[162] ING (2004) p.18
[163] Güttler and Hackethal (2005)

products has developed constantly. After the call money account was establshed, mortgaging was introduced in 2003, followed by trade with fund trading in 2005 and security trading in 2007.[164]

Price: Surveys of clients confirmed that ING-DiBa has a fair and inexpensive price image. This is especially due to the attractive call money account, which paid over 2 % interest for years.[165] ING-DiBa`s chairman of the board, Ben Tellings, argued that even with a reduction of interest from 2.5 % to 2.25 % , ING would have ranked first among all competitors .This reduction would have resulted in an total return increase of € 100 million without having to fear losing many clients. Yet, as ING- DiBa realized and surpassed its RAROC target already, it transferred this excess value of € 100 million to its customers.[166] Due to its attractive interest rates for loans and savings, a strong impetus towards growth in customer base was created. Meanwhile other direct banks have offered similar or even better terms.

Place: ING-DiBa offers its products solely via the internet. However, the utilization of accounts or other services is possible throughout the internet, telephone or post. In addition, phone service is available 24 hours a day and 7 days a week, which to a certain degree provides ING-DiBa with a competitive advantage in terms of customer service compared with the a branch network.

Promotion: ING-Diba increased marketing spending from € 18 million in 2000 to € 100 million in 2004, which amounted to 23.7% of its total operating expenses. The success of this strategy is also reflected in brand awareness, which increased from 33% in 2000 to 87% in 2004.[167] Through strong marketing and attractive call money account terms, ING has positioned itself as a price leader. Even if it does not offer the best terms at all times, clients often still perceive ING as one of the most competitive brands with the best terms. ING advertises through all channels, including the internet and television. Since the 1st of May, 2003 ING-DiBa has been the main sponsor of the German basketball national team and the famous German NBA player Dirk Nowitzki, who advertises the ING-DiBa brand in several TV commercials to the ING-DiBa brand.

[164] Tellings (2009)
[165] Wübker (2006) p.149
[166] ING Diba (2004) p. 21
[167] Güttler and Hackethal (2005) p.7

People: As ING-DiBa distributes its products by means of Interactive Voice Response (IVR), Call-Centers, e-mail and the internet, its demand for personnel is limited. ING-DiBa does not employ qualified bankers, but foreign language secretaries, computer scientists or cultural scientists who are interested in the banking industry. However, expertise in the area of banking is not necessary. Instead, candidates learn the relevant knowledge in a four - week product training. In order to promote the relationship between employees and customers, ING-DiBa does not have a commission-based salary but introduced a pay scale with the labour-union ver.di in 2006, which secures fixed salaries for employees.[168]

Process: ING-DiBa`s efficient processes are reflected in a low cost structure. Total costs per client (including marketing expenditures) amount to € 0.44 at ING-DiBa compared to € 0.90 at the direct bank competitor Comdirect. B&M banks have much higher costs, with public saving banks at € 1.10, cooperative banks at € 1.28 or the Postbank at € 1.33 costs per client.[169] This is mainly due to ING-DiBa`s automated processes. For example, in August 2005, ING-DiBa automatically handled 75% of all customers' transactions and inquiries through the internet, 9% through automatic phone response and only 16 % through call center agents, who answered 80% of these inquiries within 20 seconds. Furthermore, ING-DiBa employs an automated pre-written response to incoming e-mails, when the system detects certain predefined contents. For example, in 2004 one third of 700,000 incoming e-mails were processed automatically.[170]

Physical Evidence: Physical evidence is created as e-mails and product descriptions on the ING-DiBa website. For instance, ING-DiBa provides consumer protection information for their mutual stock funds. IT includes a product description and information about risks, costs and returns. As with a package insert for pharmaceutical products, ING-DiBa informs on the risks and side effects of their products. Thus, the product description is apiece of physical evidence of the intangible service and also creates trust among the customers.

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[168] Reuter (2003)
[169] Tellings (2009)
[170] Güttler and Hackethal (2005) p. 11

6.7 Summary

ING–DiBa has penetrated the German retail banking market with a successful implementation of the direct banking business model. The MNB did not only have a first mover advantage, it also capitalized on its internal strengths and adhered to its core strategy - a concentration on few simple products with attractive pricing. In the context of this strategy, the small range of products allowed for simple and low-cost processes. Attractive pricing was achieved as ING did not operate through a branch network but rather implemented highly efficient automated ITC processes and employed call center agents. Furthermore, the `Extra Konto` was highly marketed as a teaser product. Eventually, external environmental factors such as the increased usage of the internet, increasing interest in low-risk investment products due to the crash of national and international stock markets and poor competition of industry rivalries at that time helped ING to implement its strategy successfully.

7. Conclusion

The entry mode choice decision of MNBs has been a recurrent theme in the literature of international business. However, the present economic-scientific investigations of entry into the German market are primarily limited to a static description of the business activities of foreign banks[171].

While the theories of defensive and offensive expansion explain the motives behind the internationalization endeavors of MNBs, they are not concerned with the mode choice of foreign market entry. Likewise, the OLI paradigm has been employed to explain the country choice of expanding MNBs rather than the organizational form of market entry. Transaction costs considerations explain aspects of internationalization strategy of MNBs and recent related economic working-papers focus on aspects of information asymmetry and the screening abilities of banks as an explanation of foreign market entry mode choice. However, there is no general business strategy model that assesses the wide range of bank entry modes and the corresponding decision of which business model to adapt. In particular, neither empirical studies on bank entry modes which are often only valid in a specific context, nor general market entry theories sufficiently incorporate the macroeconomic factors such as legal aspects and social or technological developments that may have a determining influence on the entry mode choice decision of MNBs.

This thesis has provided a comprehensive assessment of equity and non equity MNB entry modes into the German retail banking market. One primary aim of the paper has been to assess which variables are most determining in the entry mode decision process. Based on case examples and economic theories, it has shown that the entry mode decision is largely influenced by strategic considerations and legal constraints. In particular, the establishnent of a foreign subsidiary by acquisition is the dominant entry mode in the context of retail banking, whereas branch entry by Greenfield investment is more often used in the framework of corporate banking. This is primarily due to the fact that acquisition provides the opportunity to attain a

[171] Knoop (2006) p.3

broad distribution netwok. Furthermore, a branch is the same legal entity as its parent and benefits from larger capital resources that allow for corporate lending.

A further contribution of this thesis to economic literature involves the analysis of the impact of demographic and technological developments on the direct distribution of retail banking products. Although the number of elderly people in Germany will increase significantly in the following decades and many elderly people may prefer traditional brick & mortar branches, the direct banking sector has significant growth potential due to demographic developments. In particular, the increase in customers who grow up in the age of the internet will benefit the distribution of banking products through direct channels. This development is illustrated in the rapid growth of market share for direct banks with regard to consumer loans and deposits that mature daily. This trend is supported by technological progress, which enables customers to exploit the benefits of internet banking. As an example, improvements in mobile banking are currently complementing direct distribution and will substantially enhance the convenience advantages for retail customers.

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Appendix: Structural analysis of the German retail banking market

Threat of Entry:

+ low legal entry barriers for MNB from the EEA, low-medium for third countries respectively

+ low customer switching costs

+ large scale operations required

- high capital requirements

- high incumbency advantages

Bargaining Power of Suppliers:

+ increased usage of complex ICT systems

+ /- human resource employed

Existing Industry Rivalry:

+ high fragmentation

+ low product differentiation

+ three pillar system

+ low industry growth

+ high exit barriers

-growth through direkt banks

Bargaining Power of Buyers:

- Low transaction volumes

-/+ medium switching costs

+ decreasing brand loyality

+ more informed

+ high price transperency through the internet

Threats of substitute products and services:

+ non- and near banks

+ insurance companies

+ trade loans

+ P2P lending

Abstract (English):

In the aftermath of the recent financial crisis and in times in which banks rediscover the private individual, significant attention is now being paid to the market entries of foreign multinational banks, which are increasingly able to penetrate the German retail banking market. In light of technological and demographic developments, this thesis examines the entry mode choice decisions and business model considerations of multinational banks. Building on current research on the entry mode strategies of multinational banks, this thesis presents a hierarchical model of bank entry mode choice. In the context of a two-tier entry mode choice model, this thesis then compares the establishment of a foreign branch via Greenfield investment with the establishment of a foreign subsidiary via acquisition. Furthermore, it examines the impact of macroeconomic factors on the decision between a direct bank and a brick & mortar bank business model. Due to distribution advantages and capital requirements, this thesis finds that the establishment of an independent subsidiary by acquisition has advantages compared with other entry modes in the German retail banking market. Furthermore, this thesis demonstrates that current demographic and technological developments would more likely favor direct distribution channels than those of traditional brick & mortar nature. This is further illustrated in a case analysis of the market entry of ING- DiBa in Germany.

Abstract (German):

In der Folgezeit der jüngsten Finanzkrise und in Zeiten, in denen Banken sich wieder verstärkt auf den privaten Kunden konzentrieren, geraten Markteintritte von ausländischen multinationalen Banken immer mehr in den Fokus. Mit innovativen Ideen und günstigen Kostenstrukturen gelingt es diesen zunehmend, den deutschen Retail-Banking Markt zu durchdringen. Vor dem Hintergrund technologischer und demografischer Entwicklungen in Deutschland, untersucht diese Diplomarbeit Marktzugangsformen und Geschäftsstrategien von multinationalen Banken. Dabei wird auf dem aktuellen Forschungsstand aufbauend, ein hierarchisches Modell der Marktzugangsformen von Banken entwickelt. In einem zweistufigen Markteintrittsmodell vergleicht diese Arbeit die Errichtung einer Niederlassung mittels Neugründung mit der Errichtung einer ausländischen Tochtergesellschaft mittels Übernahme einer bereits existierenden Bank. Außerdem wird der Einfluss von makroökonomischen Entwicklungen auf die Entscheidung zwischen direkten und traditionellen Distributionskanälen untersucht. Diese Arbeit zeigt, dass die Errichtung einer unabhängigen Tochtergesellschaft durch Übernahme, aufgrund von Distributionsvorteilen und Kapitalmittelbestimmungen, Vorteile gegenüber anderen Markteintrittsformen in den deutschen Retail-Banking Markt hat. Außerdem wird gezeigt, dass gegenwärtige demografische und technologische Entwicklungen eher direkte, als traditionelle Distributionskanäle im Retail-Banking begünstigen. Dieser Umstand wird außerdem in einer Fallstudie über den Markteintritt der ING Group in Deutschland veranschaulicht.

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