# The Competitive Edge of the Nordic Financial Sector

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# Research Project:
# "Nordic Finance and the Good Society"

- **A research project on how the financial sectors can stand strong in the future and create more jobs**
  - The project will focus on business strategies and governance, but will also address policy and regulation issues

- Through a number of research articles and a concluding reports, **the project aims to find new Nordic strategic profiles for the financial sectors, which can be a road to growth**

- **Global research team (CBS, IMD, Yale, Oxford, SDU, AAU, KU, Hanken, Lund etc.) with more than 20 researchers**

The initial research is supported by leading players:

- *Industry Players:* ***Danske Bank, Carnegie and SparInvest***
- *Political support:* ***Nordisk Råd***
- *Unions:* ***Finansforbundet and Nordic Financial Unions***
- *Industry associations:* ***Finans Danmark and Lokale Pengeinstitutter (LOPI)***
- *Educational institutions:* ***CphBusiness, Copenhagen Business School (CBS)***

- Funding of DKK 12 mil is secured – The project runs through 2018.

# The New Landscape

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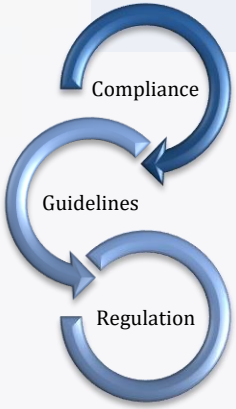
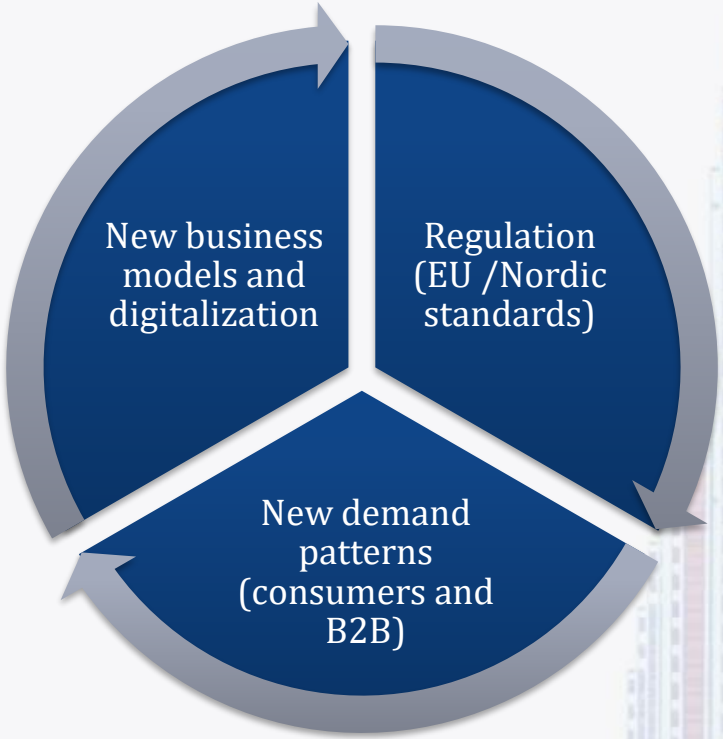
# Understanding the New Normal: The Role of Demograpics

- We have a rapidly aging population - both in the US and in Europe
- Real impact on GDP: 1.25 % on (40 % drop compared to the past) (Source: Gagnon, Johansen, etc)
- Abudance of capital (which used to be the scarest part in the previous decades)
- Very different risk profile with a changing age profile

# 3 Megatrends are Challenging the financial Sector




These factors and general framework conditions will decide the future of the current players

# Risk of Hypercompetition

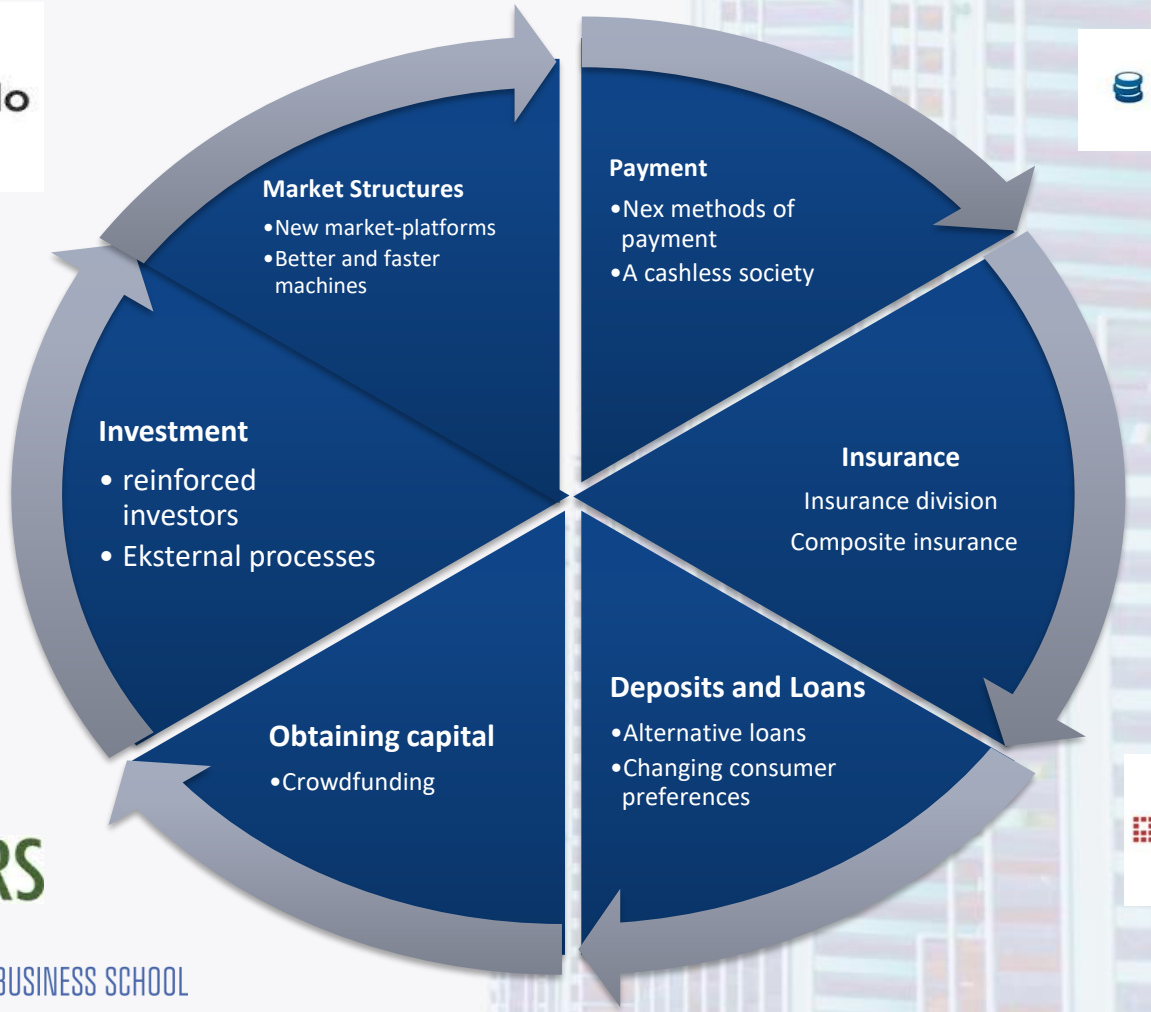
The issue of some industries exposed to hypercompetition was highlighted already by Schumpter in the 30's - and later on by D'Aveni

Their findings are

- Speed of change is industry-specific
- Competitive advantage is only transitory
- Continuously focus on innovation and recreating business model
- "The winner takes it all" - syndrome

In Europe, the typical industries exposed to hypercompetition are: IT, telecom, medicine (expiry of patent) and **now the financial sector**

# Consolidating Taxonomy in the Financial Sector

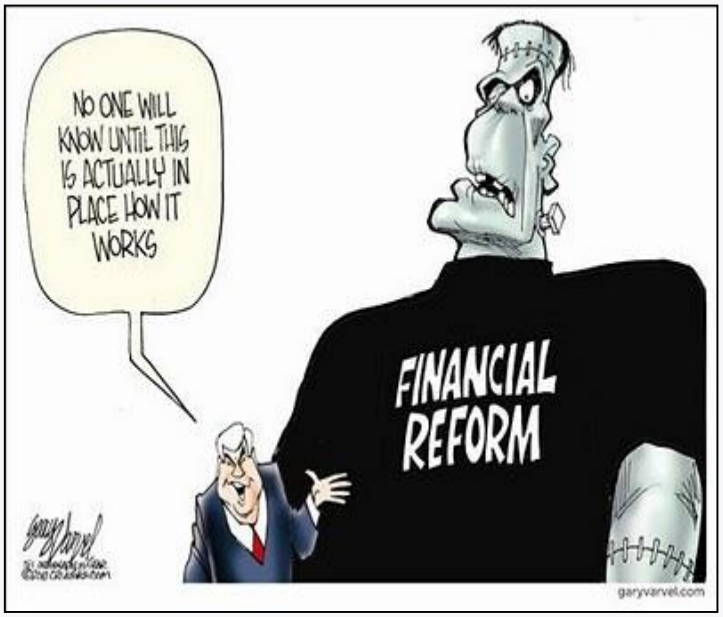



Source : World Economic Forum - 2015

# The Risk of New Generation Business Model for the Incumbents

- "The winner takes it all" - syndrome (PayPal, Mobilepay, etc.)
- Speed (market penetration) is exceptional fast
- They are scalable and in many cases born as global players
- **New players have very little fixed overheads (no branches, no legacy costs, different employee costs, etc.) compared to the current industry incumbents**

# Regulation and De-regulation - A Never Ending Pendula




| De-regulation | New Regulation |
|---|---|
| • Collapse of Bretton Woods (in 1971)<br>• Movement of Capital (EU)<br>• Borderless Society | • Basel II / Basel III<br>• Capital Market Directive<br>• MiFID<br>• Investment Service Directive<br>• Etc. |

Avalanche of new regulation

# Nordic Perspective - Regulation

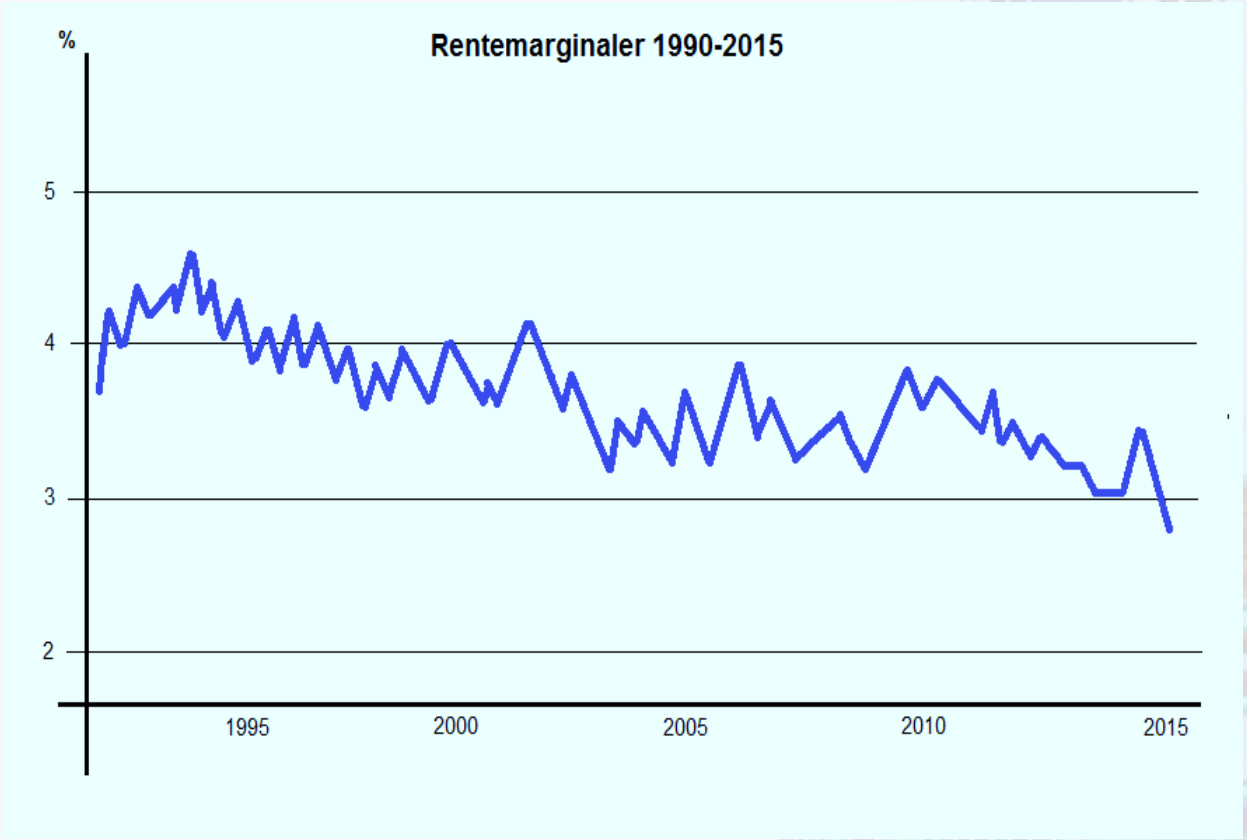
**We are inside the limits of the EU rule book, but…**

- What should be our guiding corporate governance model? (Nordic, French, Anglo-Saxon, etc.)
- The local FSA and what will be their role towards the local industry? Latest changes and signals might open up for a new dialogue
- **Could Nordic regulation become a competitive advantage**?
- **The Nordic sector isn't measured against other leading financial sectors**

# Are Traditional Banks a Good Investment?

- Regulation will mean smaller returns for shareholders (and need for more capital)
- Low inflation will create lower margins
- Studies (from Switzerland) shows that returns will fall with 6-8 %
- This will create less interest in investing in banks

# Interest Margins are Declining




New Players:

**Santander**
**Norwegian**
**IKANO**
**Maersk**
**Etc.**

Will create additional pressure

# Market Expectations for Companies Listed on the Stock Exchange

**The Stock Market tends to favor:**

- **(-)** Growing markets (low inflation, aging population, etc.)
- **(+)** Predictable business models
- **(+)** High margins (The Nordic has 50 % cost/income ratio)
- **(+)** Stable income (Yes, in the current environment)
- **(-)** Well-defined risks and low political risks

# RoE for 607 Nordic Banks

## (2006 – 2013)

| | | RoE Target | | | No RoE Target | | |
|---|---|---|---|---|---|---|---|
| | | Obs | Mean | Std. Dev. | Obs | Mean | Std. Dev. |
| **Size** | Total Aktiver (billions of dollars) | 670 | 62.70 | 139.00 | 3,621 | 6.00 | 26.90 |
| **Earning and Management** | RoE | 669 | 8.03 | 9.85 | 3,619 | 5.44 | 30.03 |
| | Return on risk-weighted assets (RORWA) | 619 | 3.47 | 57.40 | 2,646 | 15.26 | 457.36 |
| | Cost-to-income ratio | 658 | 61.43 | 39.77 | 3,543 | 62.25 | 39.26 |
| **Asset quality** | Non-earning assets to total assets | 666 | 5.18 | 6.32 | 3,618 | 6.35 | 13.12 |
| | Loss on loans | 633 | 0.49 | 1.22 | 3,199 | 1.15 | 12.67 |
| | Total risk-weighted assets (billions of dollars) | 619 | 0.26 | 0.52 | 2,647 | 0.03 | 0.09 |
| **Capital adequacy** | Total capital ratio | 654 | 17.57 | 17.97 | 2,842 | 19.28 | 13.42 |
| | Tier 1 capital ratio | 591 | 16.15 | 18.97 | 2,336 | 17.89 | 13.34 |
| | Equity-to-total assets | 670 | 8.84 | 8.85 | 3,620 | 14.24 | 17.40 |
| **Liquidity** | Loan-to-deposit ratio | 606 | 4354 | 28825 | 2,995 | 5286 | 219283 |
| | Liquid assets to deposits and short-term funding | 657 | 41.46 | 87.04 | 3,388 | 28.82 | 69.22 |
| | Deposits and short-term funding to total liabilities | 667 | 60.64 | 26,34 | 3,451 | 79.90 | 25.85 |
| **Dividend** | Dividend payout ratio | 130 | 43.91 | 62.31 | 194 | 43.40 | 57.78 |

Only in 40 % of the cases were RoE targets achieved

# Do we have the right Nordic ingrediens?

| Cases | |
|---|---|
| Mortgage system | Conceptually the best world |
| Private Equity | Strong pool of players |
| Ship financing | Norway,- a global leader |
| Start –up / IPO | Number one in Europe |
| Asset Management | Nordic managers are ranked in the top by Morningstar |
| Pension system | OECD = best in the world |

# But – Classic Nordic Business Models

**Current challenges**:

- They are **not initially created as global business models** (exceptions are few (Saxo Bank))
- **Younger consumers love their brands** and are not loyal to their bank or financial advisors
- **It is based on higher margins**. This is problematic when margins suffer from low inflation, growing competitiveness, and increasing regulation
- **Wrong IT platforms.** They are often from a time with mainframes and datacentres.
- **Employees' competence profiles are being challenged.**
- **Are capital intensive** (Can they create a reasonable return for the shareholders?)

# A Suistainable Sector?

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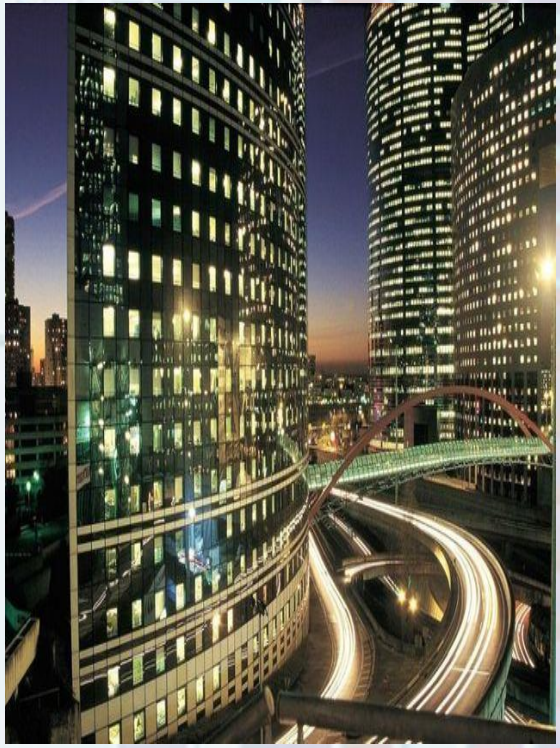
# The Solution of Fundamental Problems in the Society – The Big Picture

- The real estate market is responsible for up to 50% of all C02 emissions on a global plan (forget about your car, air travels or shipping transport, etc.)
- The movement from country side to urban area is 2,5% annually
- In 2050, MRSA resistance will be a bigger killer than cancer
- 50 % of all young women will live to be more than 100 years old



# The Responsibility of the Financial Sector

- 60-80 % of all buildings are financed by different debt-products, primarily from banks and mortgage institutions – but no special CSR lending
- Aggressive lending is leading to real estate bubbles in all major cities in Europe
- Farmers have a limited equity (10 – 20 %)
- People with savings expect their pensions to correspond to their needs (but all players are moving from defined benefits to defined contributions)

# Transition Mechanism

All banks and financial institutions are intermidiaries between lenders and borrowers. Therefore, they have a big influence on:

- Which sectors will grow or die……( Lending to SME's)
- Destinies of individual companies (most companies in Europe are still financed by debt)
- Growth and opportunities for each citizen

# Consumer Demand and Perception

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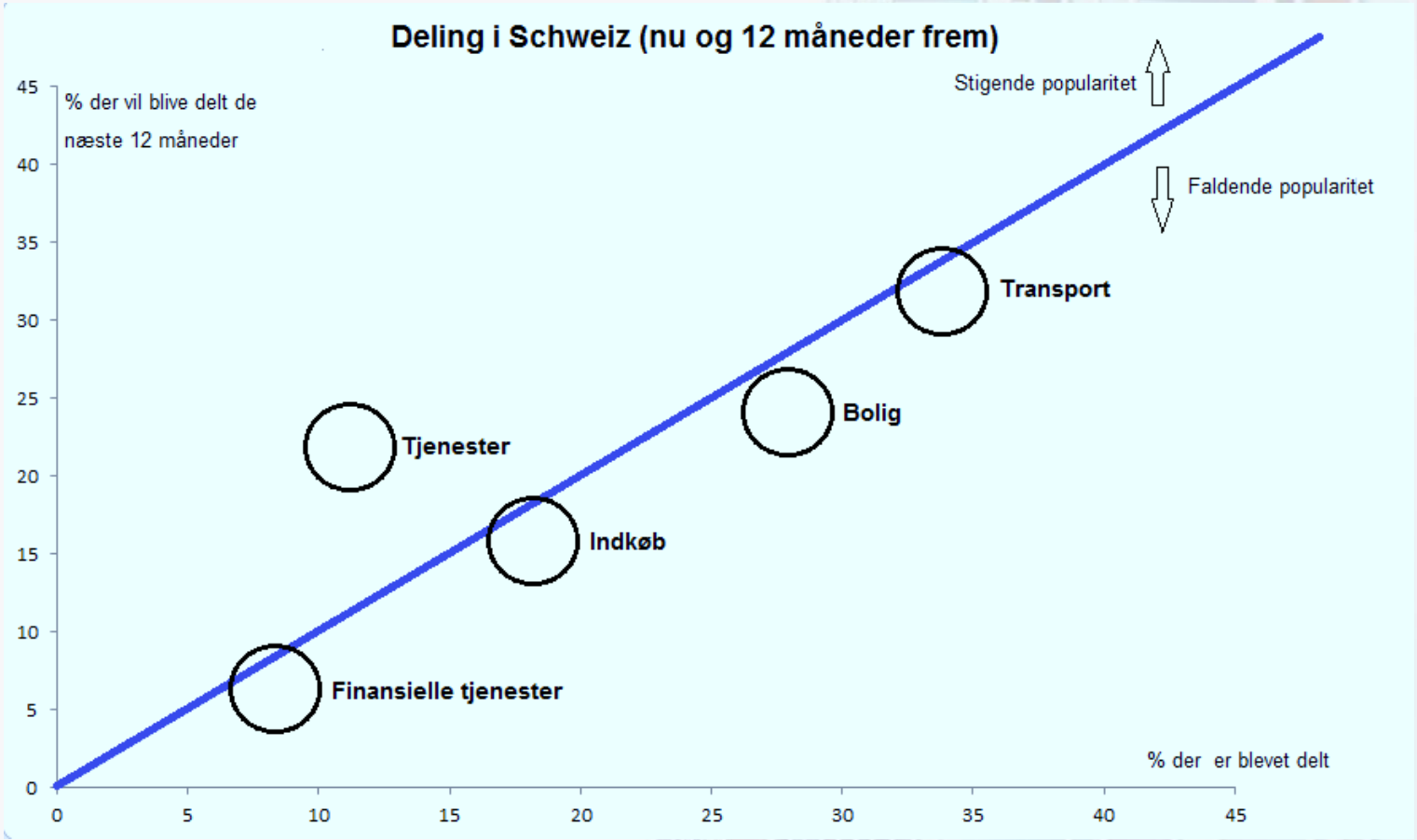
# Time for New Business Models?

**The market determines where the demand will be largest in the future – Nevertheless:**

- European companies would like to have the right capital structure (which demands the right combination of equity and debt).Should banks only be providing loans?
- Financial advice is essential . Many customers would like to have access to new financial products but in an independent way.
- Platforms for pooling of risks ( housing / cars, etc) - Old Nordic model

# The Consumer Test - Sharing of Goods and Services




Made by : Deloitte 2015

# Perception of the Financial Sector

- This is a general area of concern and wrong perception "**Investors are old, male and cigar smoking**"
- We need to highlight the link to growth, start-ups and regional development in order to change this picture
- Female profile

# Perception – Choice of Brands

**Consumers**

- There is no other sector where **trust and brand values are so important** as in the financial sector (Source: Quelsch, 2003, Park, 1999)

- Traditionally, less then 3% of the consumers changed banks (Source: Danske Bank) but unfortunately:
  - **Many consumers have lost their trust in their banks during the crisis.**
  - **Only 4% of the younger customers (under 35) has no relation to branch office or a financial advisor**.

**Brands**

- A brand is unique and almost impossible to copy (Source: Aaker, de Chernatony )

# Financial Literacy – A Global Problem

***The fundamental problems are;***

- ***Only one in ten students across participating OECD countries and economies is able to tackle the hardest financial literacy tasks (OECD 2012***
- A 2015 Standard & Poor study on global financial literacy found that just 30 - 35 % are literate
- ***Gender gaps in financial literacy or " The Gender Gap That No One's Talking About "*** **( Huffington Post – August 2016)**

Unique opportunity to create a new perception of the financial sector

# Are there growth opportunties from a Nordic perspective?

Growing middle class **+1 mia**.

We are part of the largest financial market in the world **(EU).**

| Growth in GDP | 1980-2015 | Citizens. |
|---|---|---|
| **Nordic Countries** | 1.7 | 26 mil. |
| **EU** | 1.5 | 338 mil. |
| **USA** | 1.8 | 319 mil. |
| **China** | 8.7 | 1357 mil. |
| **India** | 3.9 | 1252 mil. |
| **Korea** | 5.4 | 50 mil. |
| **Singapore** | 4.5 | 5 mil. |
| **The World** | 1.4 | 7,300 mil. |

**Source: World Bank 2015**

# Export possibilities – An opportunity?

- **The European Banking and Capital Market Union will open for an unprecedented market of financial services to more than 508 mil habitants**.
- Increasing demand for saving products and the European asset management industry grew annually alone with + 5 % from 2008 to 2015 (source: Mckinsey)
- Strong potential export platform (Nordic Corporate Governance, compentencies, ratings, IT infrastructure etc. )
- **But the Nordic export track record outside the asset management and IT industry is limited**.

# Do We Have Other Parameters of Competitiveness – Are the Nordic Countries Unique?

| | Nordic average rank | Other countries' average rank | F-test | T-test | T-test as control of BNP |
|---|---|---|---|---|---|
| **Legislation** | 3.6 | 106.1 | 837.31*** | 29.84*** | 2.79*** |
| **Government effectiveness** | 4.6 | 104.0 | 658.04*** | 25.65*** | 1.94* |
| **Quality of regulation** | 11.4 | 103.8 | 250.61*** | 15.83*** | 0.81 ns |
| **Control of corruption** | 4.0 | 104.2 | 662.89*** | 25.75*** | 2.67*** |
| **Vote and responsibility** | 4.3 | 106.1 | 583.07** | 24.15*** | 3.52*** |
| **Political stability** | 14.3 | 104.3 | 219.96*** | 14.83*** | 2.13** |
| **Leadership in general** | 3.9 | 106.6 | 682.54*** | 26.13*** | 2.75*** |

Kilde: Steen Thomsen, 2014

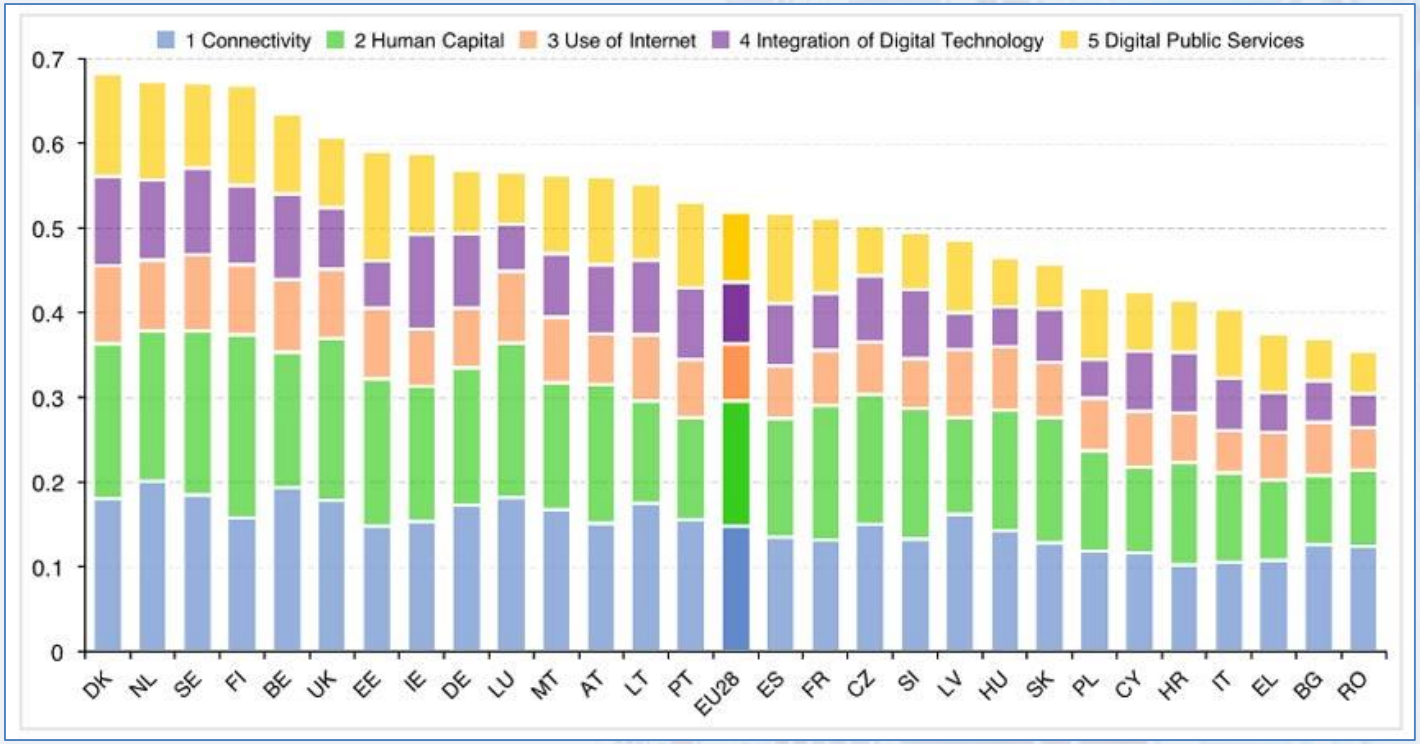
# Global Competitiveness & The Financial Sector

- **Competitiveness** pertains to the ability and performance of a country or company to sell and supply goods and services in a given market.
- Empirical observation confirms that resources (capital, labor, technology) and **talent tend to concentrate geographically** (Easterly and Levine 2002).
- The process of "**clusterization**," the creation of "value chains," or "industrial districts" highlight the advantages of networks.

Could the Nordic region become a leading financial cluster?

# Nordic Digitalization compared to other countries

## The Nordic countries are leading EU digitalization




*Source: The European Commission*

# Digitalization and technology

**Overall, The Nordics are basically ready for this challenge**

- **Factor conditions;**
- ✓ Infrastructure
- ✓ Employees & Competencies ( but training is required)
- ✓ Demand and customers willing to test new technology
- ✓ Increasing strong start-up scene and strong fintech environment

# Nordic Financial Sector - Conclusion

- The Nordic financial sector is challenged both nationally and internationally
- However, EU and **globalisation gives unique growth possibilities for the Nordic banks**
- Nordic financial sector is large and diverse in size
- Strong business models are in place