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The Perception of Value Creation by Relationship Managers in Corporate Banking ---- Insights into Relationship Banking

By

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Thesis Submitted for Doctor of Philosophy

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Abstract

This study explores the value creation in relationship banking from the relationship managers' perspective. A grounded theory approach (Strauss and Corbin, 1998) is adopted that theory is derived from data, systematically gathered and analyzed throughout the research process. This study derives concepts and categories from primary data and identifies relationships among these theoretical elements. This study provides a comprehensive picture of relationship banking as a social phenomenon, and supplies some theoretical and managerial implications. Moreover, this study links the literature relevant to relationship banking from different disciplines. This is a new way of looking at the relationship banking phenomenon and relevant literature in an integrated manner.

This study conducted research to investigate why the case banks establish long-term relationships with corporate customers? The case banks considered macro conditions including the advances in technology, financial deregulation, and business globalisation when they adopted relationship banking. The interviewees perceived that relationship banking was efficient for managing risk, effective for saving cost and necessary for cross-selling. Some intervening conditions including customer information and knowledge, customer needs and customer confidence also influence the development of relationship banking. This study investigated how the case banks establish and maintain these relationships and how they organise and motivate relationship managers? The case banks built a relationship orientated corporate culture, organised employees around customer relationships and employed customer-value based performance measurement and incentive-based reward system. The employees cooperated inside the organisation and communicated with their customers regularly, exchanged information and provided relationship transactions. This study also investigated how the case banks and corporate customers get benefits from relationship banking? The interviewees perceived that the corporate customers gained benefits including fund availability, product availability, service quality, in-time help, and business platform. The case banks gained benefits including reduction of credit risk, increase in income, sustainable profit, customer satisfaction, employee satisfaction.

The findings were integrated and linked to some banking, finance, organisation and marketing literature related to relationship banking phenomenon. The case banks increased internal service quality through employee relationship management and improved employee satisfaction. The interviewees perceived that the corporate customers received benefits in the corporate banking market by customer relationship management. The increased customer satisfaction resulted in customer retention and profit to the case banks. The case banks perceived that added shareholder wealth improved shareholder satisfaction. This study concluded that the case banks, which had more relationship banking competitive advantages and better relationship banking, related processing systems were expected to outperform the competing banks.

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Executive Summary

During the last two decades, the corporate banking market was more and more competitive because of the environmental changes. More and more bank managers realized that customer relationship is a fundamental asset and a source of competitive advantage. Many banks adopted relationship banking as a business strategy to establish long-term relationships with corporate customers. They exploited customer relationships to increase income and make stable profits. Moreover, they created a sustainable competitive advantage through relationship management. However, the relationship banking literature is very fragmented. There was not a comprehensive theory related to relationship banking. Moreover, in practice, many managers in banks and consulting companies had some misunderstandings about relationship banking. This study explores the value creation in relationship banking from the relationship managers' perspective and offers new insights into and a better understanding of relationship banking. One of the contributions of this study is that it systematically investigated the structure and process of relationship banking including context, causal conditions, actions and consequences. This study derives concepts and categories from primary data and identifies relationships among these theoretical elements. This study provides a comprehensive picture of relationship banking as a social phenomenon, and supplies some theoretical and managerial implications. Another contribution is that this study links the literature relevant to relationship banking from different disciplines. This is a new way of looking at the relationship banking phenomenon and relevant literature in an integrated manner.

Because of the nature of the selected social phenomenon and the characteristics of the research question and purpose, a grounded theory approach (Strauss and Corbin, 1998) is adopted that theory is derived from data, systematically gathered and analyzed throughout the research process. The researcher interviewed 22 corporate banking managers in 15 case banks to collect primary data and secondary archival data was used to complement the first-hand data and cross-check information. The grounded theory is developed from the data by employing systematic methods of analysis including open coding, axial coding and selective coding. In this study, the grounded theory of relationship banking is presented as a paradigm model (Chapter 5,

p88). Case quotes are used throughout these sections to illustrate the elements through interviewees' voices and thus grounding the theory explicitly in the case data. Moreover, relevant literature is integrated into the presentations of data indicated theoretical elements (Locke, 2001).

The phenomenon of interest in this investigation was relationship banking. The context of this study was the corporate banking market. The causal macro-conditions of relationship banking included advances in technology, financial deregulation and business globalisation. The micro-conditions included effectiveness of risk management, cost effectiveness and exploration of cross-selling. The intervening conditions included customer needs and customer confidence.

The interviewees perceived that these macro-conditions increased competition in corporate banking market and provided opportunities for the case banks. The case banks adopted a relationship-banking strategy to meet the challenge and exploit the opportunities. In order to reduce credit risk, the case banks learnt that knowing the customer and understanding their businesses were essential for making decisions. The interviewees argued that keeping a customer was more cost effective than acquiring new customers. Furthermore, establishing long-term relationship with corporate customers facilitated the case banks to explore cross-selling opportunities.

The case banks thought that the corporate customers wanted to establish long-term relationships because of the characteristics of customer needs. Corporate customers would purchase several products and financial services from the banks and some of these products and services were purchased very often. Furthermore, customer confidence was very important and expected to be built on long-term relationships. Every company would have bad times at some points. The case banks perceived that the corporate customers wanted to make sure that the bank would help them when they had financial difficulties.

In the case banks the strategic actions/interactions included relationship orientation, customer-centric organization, customer value based performance measurement, incentive-based compensation. The ongoing actions/interactions included trust-based personal communications with customers, internal cooperation within the team and

among divisions, exchange of information with customers and relationship transactions.

A relationship orientation was a strategic choice of corporate culture that the case banks treated the customer relationship as a source of competitive advantage. Customer-centric organizational structures provided a foundation for developing and implementing this culture. A customer value-based performance measurement and incentive-based compensation system was also important for relationship banking in the case banks. The Balance Scorecard was increasingly implemented in the strategic performance measurement system combining qualitative and quantitative indicators. Incentive-based compensation motivated relationship managers to build and maintain these trust-based personal relationships with corporate customers.

The nature of bank-corporate relationship was trust-based personal interactions. The case banks established personal relationships through multi-level communications. Customer-centric organizational structure enabled cooperation within the team and among divisions. The case banks exchanged information through regular contacts with corporate customers. By having more customer information and knowledge the case banks identified customer needs and explored cross-selling opportunities and conducted relationship transactions overtime.

The consequences were divided into customer and bank consequences. The intended consequences or benefits of relationship banking for the customer included credit availability, product availability, and service quality, in-time help and business platform. The intended outcomes for the case banks included reduction of credit risk, increase in income, sustainable profit, customer satisfaction, and employee satisfaction.

The interviewees perceived that relationship banking customers were able to get more funds. Having more information the case banks evaluated credit risk and made quick decisions. Moreover the relationship managers believed that they developed tailored solutions and delivered the financial products and services properly. The corporate customers received in-time help when they had financial difficulties. The relationship managers also introduced some business opportunities among their customers.

By understanding customers' business the case banks reduced credit risk and by gaining more information and knowledge of customers' business the case banks were able to quickly respond to their financial requests and explore cross-selling opportunities. In addition, customer retention was more cost effective than customer acquisition. Keeping a stable customer base the case banks maintained sustainable profit. The increase of customer satisfaction enabled the case banks to keep the customers and explore cross-selling opportunities. The case banks gained sustainable profitability by increasing employee satisfaction and keeping their good employees because the employees were a source of sustainable competitive advantage that could not be duplicated by the competitors.

This study integrated the findings and linked to relevant literature. The value creation process model (Chapter 9, p209) connected banking, finance, marketing, strategy and organisational literature. In the organisation the employee relationship management increased employee satisfaction and therefore the employees established long-term relationship with corporate customers and provided benefits to corporate customers. In the corporate banking market, customer relationship management increased customer satisfaction and gained more profit for the case banks. Consequently the increased profit increased shareholder wealth in the stock market and therefore improved shareholder satisfaction. The interviewees perceived that the employees created value and the value was allocated among employee, customer, shareholder and some other stakeholders. There was a positive relationship between employee satisfaction, customer satisfaction and shareholder satisfaction. In the short run relationship banking needed to balance these stakeholders' benefits but accepted long-term value maximisation as the firm's objective.

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Chapter 1: Introduction

1.1 Introduction

This first chapter introduces the background and problems in corporate banking and relationship management relevant to this dissertation. The research questions and research objectives and the structure of the dissertation are proposed. The central phenomenon, relationship banking, and the key terms in this study are defined.

1.2 Background

During the last two decades, the financial services sector experienced profound changes in structure and in the nature of competition. Among many others, such changes have included the extraordinary advances in the use of new communication and information technologies, a sweeping trend of financial deregulation, the globalization of financial markets (Lence, 2002). The environmental changes in financial markets had a major impact on financial institutions. Banks have been confronted with an ever-increasing competition from capital markets and financial institutions (Boot, 1999). These are likely to affect the profitability and the riskiness of banks (Buch, 2000). Empirical research shows that the profitability of traditional banking activities such as business lending has diminished in the US, Japan and European countries (Edwards and Mishkin, 1995; Molyneux et al, 2004).

Frame and White (2002) find that banks are intensive users of both IT and financial technologies. The development in computing and communications has had a dramatic impact on the financial services industry. Accessing cash through ATMs, transferring funds, paying bills, and checking interest rates over the phone or through a computer are readily available services at many banks. Some other banking technologies include Internet banking, electronic payments technologies, and information exchanges (Berger, 2003). The development of technology increased the speed and lowered costs of computing and telecommunications. Financial service providers can offer a broader array of products and services to larger numbers of clients over wider geographic areas than ever before (Bauer and Higgins, 2002). On the one hand,

technological advances combined with financial engineering techniques have enabled service providers to innovate tailored products and services to meet customers' specific needs. On the other hand, many financial products have been converted into commodities, characterized by a high degree of standardization and competition focused on price. Online delivery channels make it possible for out-of market institutions to compete for customers as well (Claessens, Glaessner and Klingebiel, 2002).

In a number of countries, financial regulatory frameworks have shifted from systems based on strict regulatory control to systems based more on enhancing efficiency through competition. For example, in Europe, financial market deregulation has been shaped both by the abolition of capital account restrictions and the adoption of common legislative standards. The Single European Act, which was signed in 1986, formally established the removal of obstacles in order to create an internal market. The introduction of the euro in 1999 has marked a milestone in the integration of financial markets in Europe. Molyneux and Ibanez (2002) demonstrate that European banking markets have become increasingly concentrated and competition appears to have intensified. In the US, the Gramm-Leach-Bliley (GLB) Financial Modernization Act went into effect in 1999. The Act establishes a new framework for affiliations among commercial banks, insurance companies and securities firms through "financial holding companies" and "financial subsidiaries", and establishes guidelines for entry into merchant banking. It moves financial institutions in the United States towards a system of conglomeration (Shull, 2000). In Japan, the financial system Reform Act of 1993 allows banks and securities companies to engage in each other's areas of activity through wholly owned separately capitalized subsidiaries (Hall, 1998).

Financial liberalization allows intermediaries to choose which activities to engage in and which products services to supply according to their perceived comparative advantage. Accordingly, banks will be allowed to sell insurance, securities, investment trust certificates through their branch networks. At the same time other non-bank financial institutions are allowed to do traditional banking services. For example, companies such as GE, Tesco, and Sainsbury successfully provide financial

services. In the new operating environment, public policy is less protective of banks, exposing them to the same sorts of market pressures that have long confronted non-financial businesses (Kleinert and Klodt, 2002). This process of regulatory reform in financial services combined with the effects of advances in technology, innovations in financial engineering and other developments increased the competition in financial markets but also gives banks increased flexibility to respond to competitive impulses (Carter, McNulty, and Verbrugge, 2004; DeYoung, Hunter, and Udell, 2004).

Globalization is in many respects a by-product of technological advances and deregulation. Technological advances have lowered computing, telecommunicating and transport costs, while at the same time greatly expanding capacity, making a global reach economically more feasible. Deregulation, meanwhile, has opened up many new markets, both in developed and in transition economies. As non-financial corporations increased the geographic scope of their operations, they created a demand for intermediaries to provide products and services attuned to the international nature of their operations (Calomiris and Karceski, 1998). Therefore, global banking proliferated as a result of a great increase in demand from companies, governments, and financial institutions (Biles, 2004).

The globalization of capital markets also contributes to the shift from a bank-centered system to a market-based one. Improvements in information technology, which have made it easier for households, corporations, and financial institutions to evaluate the quality of securities, have made it easier for business firms to borrow directly from the public by issuing securities. Even in countries where securities markets have not grown, banks have still lost loan business because their best corporate customers have had increasing access to foreign and offshore capital markets such as the Eurobond market. The traditional intermediation offered by banks has lost ground to other companies---financial or non-financial, thus giving rise to the phenomenon of financial dis-intermediation[1] (Canals, 1997). On the liabilities side of banks' balance

[1] Financial Dis-intermediation: Withdrawal of funds from a financial institution in order to invest in them directly. http://www.trading-glossary.com/d0235.asp

sheets, there has been a substantial outflow of deposits to a wide range of competing financial products offered by various institutions in different sectors.

To survive product obsolescence, overcome the onslaught of superior competitors, the only permanent factor is the customer. If banks want to compete more effectively, they have to focus themselves to meet the needs of the customer more efficiently (Kohli and Jaworski, 1990). In order to maintain customer loyalty, they have to develop long-term relationships with their customers—which suggests learning the preferences of customers and continually meeting their needs over time (Kahn, 1998). There is evidence to suggest that customers have and value relationships with financial service providers (Barnes, 1997; Colgate and Lang, 2001; Harrison, 2000). As a result, financial services providers had to shift from product and transaction orientation more and more towards relationship orientation and customer focus, especially in corporate banking (Payne et al, 1998). More and more banks realized that customer relationships are valuable assets and a source of competitive advantage (Woodruff, 1997). Many banks choose relationship banking as a way to do business in corporate banking (Cameron, 2003).

The challenge now is to keep pace with the ever-changing expectations of each customer since customers are more aware and have more options. Corporate banking success depends on the banks' ability to build and maintain loyal and valuable customer relationships. More and more people realize the importance of strong customer relationship in building sustainable competitive advantage. According to a survey by Datamonitor[2] 80% of bank managers believe that Customer Relationship Management (CRM) is a key determining future success and three quarters of financial service firms have a CRM programme. Worldwide expenditures for CRM in all sectors are expected to reach $148 billion by 2005 (CXO Media[3]). Global Banking Industry Outlook[4] identifies the top-10 issues that banks face in 2004 in which the

[2] Datamonitor plc is a business information company specialising in industry analysis. http://www.datamonitor.com/

[3] CXO Media Inc. offers the information for top executives across all industries. http://www.cxo.com/

[4]The Global Financial Services Industry Outlook series is jointly developed by Global and U.S. Deloitte & Touche LLP. http://www.deloitte.com

first one is improving the customer relationship. CIBER[5] UK partnered with a specialist wholesale banking consultancy in London, Capital Markets Partners, to conduct a comprehensive banking relationship survey of corporate financial executives in the UK in 2005, in which it is found that relationship management is more important than ever for winning and maintaining profitable business in the corporate banking market.

A few examples of bank disclosure in their annual reports 2003 about relationship banking are shown below. "The Right Relationship is everything" — Chase Bank. "Building successful relationships" --- Royal Bank of Scotland. "At Bank of Scotland, we solve problems with one simple philosophy --- relationship banking." Lloyds TSB, with wholesale banking contributes close to 50% of earnings and over half of the bank's assets, shows that: "We offer a unique approach to relationship banking which allows our customers to use a service tailored to their distinctive needs. We aim to help them succeed by forging a strong relationship, listening to their ideas, and working with them to deliver expertise which will support in the achievement of their business objectives." "HSBC operates a long-term relationship management approach to build a full understanding of client financial requirements. Clients are served by sector-based client service teams that combine relationship managers and product specialists to develop financial solutions to meet individual client needs."

1.3 Problems

However, there are some problems in understanding and implementing relationship banking. These problems are discussed in the following sections.

The term "relationship banking" is not particularly sharply defined in the literature. Apart from references to "close bank relationships," no definition of bank-corporate relationship is provided (for example, Petersen and Rajan, 1994; Berger and Udell, 1995). Boot (2000) defines relationship banking as the provision of financial services

[5] CIBER, Inc. is a international system integration consultancy with value-priced services for both private and government sector clients. http://www.ciber-uk.com/

by a financial intermediary that: (1) invests in obtaining customer-specific information, often proprietary in nature; and (2) evaluates the profitability of these investments through multiple interactions with the same customer over time and/or across products. However, this definition does not reflect the nature of the bank-customer relationship. It focuses on information and profitability from individual customers and therefore maybe more suitable for Customer Information Management or Customer Value Management. Moreover, this definition implies that relationship banking is an investment but relationship-banking concerns the banks' corporate culture, organisation structure, and incentive mechanism. The value of bank relationships has received very little attention in the existing literature (Ongena and Smith, 1998). Existing work falls short in that it does do not show how relationship banking create value therefore a sound understanding of how banks create and deliver value in relationship banking is needed (Boot, 2000). Ulaga (2003) investigates the value creation in business relationships in the manufacturing industry from the customer perspective. Because of these gaps in the literature, an empirical study is needed to investigate the value creation of relationship banking from relationship managers' perspective.

In practice, there is still confusion in some banks as to what CRM is all about. In many organizations, CRM has been "hijacked" by IT companies. CRM has also been defined as "data driven" or "IT-enabled" marketing. For example, Ryals (2004) argues that CRM is about how organisations use IT to help manage their relationships with customers in order to maximise value creation both for the customer and the company. Target Search [6] defines CRM as an information industry term for methodologies, software, and usually Internet capabilities that help an enterprise manage customer relationships in an organized way. These definitions focus on information technology, which maybe more suitable for the definition of Customer Information Management. Furthermore these definitions may be misleading. Many people think CRM means companies buying expensive technology such as a call centre, sales automation software, or even Internet-based customer service. For example, "Many vendors offer modules allowing users to build CRM solutions based on their specific needs – call centre management, e-commerce, customer support, etc.

[6] Whatis is an IT encyclopaedia and learning centre. http://whatis.techtarget.com

(About.com)[7]" "The key software components of CRM are data warehouses and the software systems that manage customer interactions". These quotations imply that CRM solutions can be bought and you are doing CRM after installing CRM software. Nevertheless, "CRM is not something you can buy, and technology is not necessarily required. Rather, CRM is a business strategy." (CRMguru.com[8]).

Relatively few organizations have implemented an integrated approach, which addresses all the key strategic elements of CRM. There is such a high risk of failure on implementing a CRM strategy. Research conducted by Cap Gemini Ernst & Young[9] reports that 70% of CRM initiatives fail. Another recent research study conducted by META Group[10] reports 90% of enterprises cannot show a positive return on CRM. Peppers & Rogers[11] reports that nearly 80% of CRM projects fail to show a positive return. Gartner[12] research predicts that over 50% of CRM strategies will continue to fail. Because of the problems in corporate banking CRM practice, a sound understanding of CRM could help the bank practitioners to improve their practice.

1.4 Research questions and key terms

The literature indicates that relationship banking is an important phenomenon in corporate banking. However, there are not many good theories in relationship banking to help the academics and professionals to understand this phenomenon. This topic is therefore chosen as a PhD study. The research question for this exploratory research is as follows:

Main question (MQ): How does relationship banking create value from bank managers' perspective?

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[7] About.com is America's single largest developer of original content on the web.
[8] CRMGuru.com is the World's Largest CRM Community.
[9] Cap Gemini Ernst & Young offers services that focus on business strategy, operations, and people and information management. http://www.capgeminigroup.com/
[10] META Group provides Custom research and consulting services. www.metagroup.com
[11] Peppers and Rogers Group is a business and management consulting firm. http://www.1to1.com/
[12] Gartner is a world's leading provider of research and analysis about the global information technology industry. http://www.gartner.com

This study explores the bank managers perceived value creation in relationship banking. The reasons why this study chooses this specific question will be discussed in Chapter 2 in the literature review. According to the grounded theory approach chosen, the interview is the main method in this study. The following broad questions are asked in the interviews.

Q1: Why do banks establish long-term relationships with corporate customers?
Q2: How do banks establish and maintain these close relationships with corporate customers?
Q3: How do banks measure relationship-banking performance?
Q4: How do banks organise and compensate relationship managers?
Q5: How do banks and corporate customers get benefits from relationship banking?

"Relationship banking" is a key term in this study, but not well defined in the literature. The following is a working definition of relationship banking adopted for this thesis.

This study defines Relationship banking as a business strategy in a financial institution to establish and exploit long-term relationships with selected corporate customers.

A selected business strategy concerns the objectives, actions, and processes. Therefore this study investigates why the case banks choose relationship banking and what the actions/interactions are and how they achieve their objectives. A full statement of the definition of relationship banking will be presented in chapter 7.

"Value" is another key term in this study. In the literature, value can be regarded as a trade-off between benefits and sacrifices (Flint, Woodruff, and Gardial, 1997). Some define value in business markets monetarily (Anderson and Narus, 1999) whereas others use a broader value definition, which also includes non-monetary revenues (Wilson, 1996). This cost-benefit equation is flexible enough to include both tangible and intangible inputs. Thus value, like beauty, is often in the eye of the beholder.

This study defines the value of relationship banking as relationship managers perceived benefits for the case banks and corporate customers in relationship banking.

1.5 Research purposes

The ultimate purpose of this research is to get insights into relationship banking and gain a better understanding about this important and interesting phenomenon. This study attempt to bridge the gap between theoretically "uninformed" empirical research and empirically ''uninformed'' theory. Contribution to academic knowledge of relationship banking is an objective. A Grounded Theory approach (Strauss and Corbin, 1998) is adopted in which theory is derived from data, systematically gathered and analyzed through the research process (Strauss and Corbin, 1998). By systematically processing data, this study identifies some categories of relation ship banking and the relationships between these categories.

This study develops a grounded theory of relationship banking that tells a complex story about the relations among these theoretical elements and shows how data fragments fit within them (Locke, 2001).

Another objective is that this study made contribution to practitioners of customer management in corporate banking. This study investigates the value creation process in relationship banking and identifies some common themes. Comparing with other case banks, the practitioners may take actions to improve their customer relationship management (CRM) in corporate banking. However, the aim of this exploratory study is to map out what is of potential importance to people involved with relationship banking and to raise questions for practitioners and theorists rather than to provide solutions or definitive answers.

1.6 The structure of the dissertation

The structure of this dissertation is outlined as follow. This chapter introduced the research motivation and research question. The key terms in this study were defined. The objectives of this study were proposed.

The next chapter examines the present state of knowledge in this field. The literature in relationship banking is reviewed and critically evaluated. The nature of bank-corporate relationship will be discussed. The benefits and problems of relationship banking will be reviewed and evaluated. The measurement of bank-corporate relationships and performance of relationship banking will also be discussed. The research questions and research objectives will be discussed through out the literature review. The literature shows that the different aspect of value sources of relationships between banks and corporations has received little attention in the existing literature. The existing work falls short in that it does not explain how relationship banking create value therefore a sound understanding of how banks create and deliver value in business relationships is needed.

Chapter 3 discusses the research methodology in this study. It proposes that the Grounded Theory approach is a suitable method to get insights into relationship banking. Strauss and Corbin's (1998) grounded theory approach is adopted in an attempt to bridge the gap between theoretically ''uninformed'' empirical research and empirically ''uninformed'' theory. Chapter 4 describes how the research is conducted. The main method to collect data is interview while secondary data such as annual reports, sectional analyses and web information, supplement the interviews. It reports how these data was processed and how theory was derived from analyzing these data.

The following chapters present the findings of this dissertation. Chapter 5 presents the overview of a grounded theory of relationship banking using a paradigm model and provides a "roadmap" to steer through the detailed results of the fieldwork and the processing of fieldwork data. Chapter 6 discusses the context, macro conditions, micro conditions and intervening conditions of relationship banking. Chapter 7

discusses the actions/interactions that the case banks adopted under these conditions. Chapter 8 discusses the intended consequences of relationship banking. Chapter 6-8 provide interview quotes to illustrate the findings.

Chapter 9 concludes the dissertation. It discusses the theoretical implications and empirical suggestions, the limitations of the research. It identifies further research opportunities and proposes hypotheses for further testing using quantitative methods in a broad research sample.

Chapter 2 Literature Review

2.1 Introduction

The previous chapter introduced the research question and defined the key terms with this research area. The research motivation was discussed and the purposes of this study were outlined. This chapter presents the state of knowledge in this field. It shows how the literature is fragmented relative to the phenomenon and a complete theory of relationship banking is needed. In this literature review some problems are recognized and research opportunities are identified to meet these gaps. The research questions and objectives are discussed throughout this literature review.

This chapter explores the role of banks in the financial market and bank-corporate relationships in corporate banking. The concept of relationship banking is discussed. The benefits and costs of relationship banking are investigated. The measurements of relationship banking are reviewed and evaluated. This chapter critically reviews the literature relative to relationship banking and recognizes the problems in conventional literature and limited field research. It argues that more fieldwork and an integrated theory are needed.

2.2 Financial market, financial intermediaries and the role of bank

The basic function of a financial market is to channel funds from savers who have an excess of funds to companies and individuals who have a shortage of funds. The financial market can do this either through direct finance, in which borrowers borrow funds directly from lenders by selling them securities, or through indirect finance, which involves a financial intermediary who helps transfer funds from one to the other (Mishkin, 2001). Two main models of organisation of the financial system include the capital-based model and the bank intermediation-based model. Some countries, like the UK and the US, have market-based systems. Financial markets are broad and deep and play a primary role in the allocation of resources. In other countries like Germany and Japan, banks play a much more important role in the

allocation of resources. These markets do not have many firms listed relatively speaking and market capitalization relative to GDP is low (Allen, 2004).

In a market-based system, many companies obtain their financing by fixed and variable yield security issues on the capital markets (Canals, 1997). The financial securities market is well developed with a high level of competition and institutional investors play an important role. The stock market has a great ability to allocate resources to the best investment projects at hand. According to the literature, the stock market plays a critical role in the development and growth of an economy, taking into account that the excessive volatility of stock prices must be controlled through a basic regulatory structure (Dittus, 1996). The intermediation-based model rests largely on the financial intermediaries. Financial intermediaries are financial institutions that acquire funds by issuing liabilities and in turn use those funds to acquire assets by purchasing securities or making loans. The primary function of financial intermediaries is described as facilitating and deployment of economic resources (Merton, 1995). Market imperfections that cause inefficiencies in direct financing are seen as the rationale behind the existence of financial intermediaries (Williamson, 1975). These imperfections come from the existence of asymmetric information problems between savers, financial intermediaries, and company managers (Stiglitz and Weiss, 1981). The existence of asymmetric information leads to agency problems (Jensen and Meckling, 1976). Financial intermediaries reduce the transaction costs deriving from asymmetric information between lenders and borrowers or possible opportunistic behaviour (Canals, 1997).

There is no empirical evidence to suggest which system is to be preferable. Scholtens (2000) argues that the most important goal would be to build a safe and stable bank system and simultaneously develop equity markets reasonably fast. Europe has developed a financial system based on both financial intermediaries and markets (Allen, 2004). This enables firms to obtain direct funding in addition to bank lending (Hermes and Lensink, 2000). Diamond (1991) and Hoshi et al. (1993) highlight the complementarity of bank lending and capital market funding. Hoshi et al. (1993) show that bank lending exposes borrowers to monitoring, which may serve as a certification device that facilitates simultaneous capital market funding. Diamond

(1991) shows that borrowers may want to borrow first from banks in order to establish sufficient credibility before accessing the capital markets. In this explanation, there is a sequential complementarity between bank and capital market funding. In related theoretical work, Chemmanur and Fulghieri (1994) show that the quality of the bank is of critical importance for its certification role. Empirical evidence provided by James (1987), Slovin et al. (1988) and Houston and James (1996) support the certification role of banks.

Boot and Thakor (1997) propose theories to explain the simultaneous existence of banks and financial markets. Whereas bank lending alleviates moral hazard through monitoring, they generate less public information. Funding via the capital markets provides reduced monitoring, but more public information. In a simple separating equilibrium, companies with good credit prefer accessing the markets, and weak credit access banks. Rajan (1992) also develops an equilibrium model where companies with better credit go to the capital markets, and weaker credit borrow from banks. However, companies acquire funds from both capital market and financial intermediaries and have their own capital structure. According to Modigliani and Miller (1958), the choice of capital structure is irrelevant to the value of the firm under the assumption of perfect markets. Jensen and Mecklin (1976) contributed to the research by adding the effect of agency cost to the capital structure discussion. They conclude that agency costs can be mitigated by preferring external debt to internal finance until the marginal agency cost of the external debt equals the marginal agency cost of the internal finance. An alternative model of capital structure, called "the pecking order hypothesis" is based on the characteristics of asymmetric information (Myers, 1984). The main idea of the model is that firms prefer internal financing to external financing because the management of the firm is not able to transfer its private information about investments reliably to investors. Empirically, managers' decisions seem to be related to the "pecking order hypothesis" rather than focused on maintaining a determined capital structure goal (Pinegar and Wilbricht, 1989).

Greenbaum and Thakor (1995), Bhattacharya and Thakor (1993) show that non-bank financial intermediaries specialize in brokerage services (like transaction services,

screening, certification), banks provide more services of qualitative asset transformation (like monitoring, liquidity creation and claims transformation). Thus, intermediation by banks differs in two important aspects from intermediation by non-bank institutional investors:

- On the liability side, banks typically take funds with standard debt contracts, called deposits, which are not only risk-free for depositors (because of diversification and deposit insurance), but also highly liquid (because of liquidity insurance). Non-bank institutional investors take funds with different risk-sharing contracts (e.g. mutual fund contracts, insurance contracts) and provide risk diversification, but not liquidity transformation.
- On the asset side, banks typically provide direct loans to firms whom they screen and monitor, while non-bank institutional investors invest in publicly traded bonds and shares or in private equity of the firms which they screen and monitor.

However, financial deregulation has blurred the difference between bank and non-bank financial institutions during the last two decades. Similar to a securities market the bank facilitates the movement of funds between savers and borrowers. Moreover, a bank has also provided liquidity and safety not available through securities markets. Rajan (1996, 1998) argues this ability to continuously offer liquidity to both borrowers and savers distinguishes a bank from "arm's-length" securities markets.

Diamond (1984), Ramakrishnan and Thakor (1984), and Boyd and Prescott (1986) argue that it is a bank's ability to reduce information asymmetries between borrowers and savers that make a bank unique relative to other financial institutions. Wriston (1986) points out that the modern function of financial intermediaries is to process information, offer and gather information, and communicate with informational operations. Other important studies have also supported the belief that banks actually generate information (Lummer and McConnell, 1989; Hoshi, Kashyap and Scharfstein, 1990). Stiglitz and Weiss (1981) argue that credit rationing occurs because of asymmetric information and hence the problems of adverse selection and moral hazard. The problems of adverse selection can be mitigated by granting lines of credit loans to firms (Thakor and Udell, 1987). In lines of credit loans, the lender

promises credit to the borrower with certain terms in the future. By monitoring the use of lines of credit, the quality of the firm is more easily verified. Also, problems of moral hazard have been shown to decrease through monitoring the use of line of credit (Thakor and Udell, 1987). Fama (1985) shows that the bank is able to receive "inside" information about its customers through the client-bank relationship. The following section will discuss the relationships between banks and corporate customers.

2.3 Bank-corporate relationships and relationship banking

The concept of bank-corporate relationship has long been perceived as important in the literature. Hodgman (1961) focuses on deposit relationships and hypothesizes that the value of a deposit relationship arises in response to competition between banks. Wood (1975) recognizes lending relationships and notes that a bank may find it profitable to offer easy or low-cost credit in one period in hopes of charging higher rates to a customer in the future. Relationships also play an important role in other markets such as syndicated loan markets (Dennis and Mullineaux, 1999), private equity and private debt markets (Fenn et al., 1997; Carey et al., 1993; Holland, 2001). Bank relationships do not involve only funding but also includes various other financial services and therefore banks obtain information by offering multiple services to the same customer (Degryse and Van Cayseele, 2000). These arguments focus on the functional aspects of bank-corporate relationships. Some other scholars understand the relationship from the perspective of time. Ongena and Smith (1998) define a bank relationship to be the connection between a bank and customer that goes beyond the execution of simple, anonymous, financial transactions.

Moreover some scholars recognises bank-corporate relationships from "the nature of relation" point of view. Holland (1993, 1994) argues that relationship types between an individual firm and bank can vary in character over a range from "close" relations to "transaction" relations. Close relationships generally involve rich information flows, regular flow of low margin business, and privileged access to big fee deals. Transaction relations involve relatively poorer information flows, ad hoc price-oriented commodity deals, and expectations of transient links between the trading

partners. Petersen and Rajan (1995) define a firm-bank relationship as the 'close and continued interaction' between a firm and a bank that 'may provide a lender with sufficient information about, and voice in, the firm's affairs'. However, a bank-customer relationship may extend the usual banking activities of deposit-taking, lending and related ancillary financial services. For example, a bank can exert direct, ownership control over a firm by participating in an external supervisory role or by holding voting equity in the firm (Ongena and Smith, 1998). Relations were also seen as consisting of a set of inter-organisational or cross-hierarchical social, managerial and technological links between the two enterprises (Holland, 1993).

These arguments show that scholars understand bank-corporate relationship from different perspectives. Berlin (1996) notices that practitioners have a different understanding of the bank-corporate relationship. When bankers speak of building a relationship with a business customer these days, they usually mean selling the customer a whole range of financial products such as lock-boxes, letters of credit, and swaps, in addition to loans. When financial economists speak of relationship lending between bankers and firms, they mean a close relationship between a firm and its banker, in which a single banker has intimate knowledge about the firm's affairs, built up over years of lending (Berlin, 1996).

Holland (1993) uses case interview and fieldwork research methods similar to grounded theory to develop bank-corporate relationship concepts as:

- Two way flows of transactions and information
- Two way expectations and commitment
- A set of cross hierarchy relations
- A mix of explicit and implicit contracts
- A dynamic bargaining process
- Set in the context of multiple relations
- Subject to change from environmental stimuli and subsequent changes within the firm or bank
- A major managerial problem of choice and administration

These concepts describe various aspects of the bank-corporate relationship. However, these concepts were developed from limited fieldwork. Many changes have occurred

since this work such as the development of information technology, financial deregulation and globalisation and therefore these concepts might need to be developed. Moreover fieldwork research methods need to be developed. It may be interesting to investigate the nature of bank-corporate relationships and how banks and customers conduct these relationships. This dissertation conducts research to investigate **how banks establish and maintain these relationships with corporate customers (Q2).**

Because of different bank-corporate relations there are different banking activities. Banking contracts can be classified as two types: transaction-based and relationship-based (Boot and Thakor, 1997). Neuberger (2005) defines transaction finance as the provision of financial services by an investor or lender that

- focuses on a single transaction rather than multiple interactions with the same contracting partner;
- involves only publicly available information.

Individual investors buy stocks or bonds issued by firms on the capital market to provide transaction finance only on public information. They reduce risk by holding a diversified portfolio of investments. Institutional investors are investors in financial markets, which are better informed and diversify their portfolio broadly (Menkhoff, 2002). Banks and non-bank financial intermediaries like mutual funds, pension funds, Insurance companies or venture capital firms, may involve in transaction finance if the loans and investments are made at arm's length.

In contrast to transaction finance, financial intermediaries provide relationship finance based on information beyond public information that is gathered over time through multiple interactions with customers and through the provision of multiple financial services (Berger, 1999). Boot (2000) defined financial intermediation as the provision of financial services by a financial intermediary that:

- invests in obtaining customer-specific information, often proprietary in nature; and
- evaluates the profitability of these investments through multiple interactions with the same customer over time and/or across products.

Because of the greater familiarity people have with the term "relationship banking" instead of relationship intermediation, the above statement provides a definition for relationship banking (Boot, 2000).

However, this definition implies that relationship banking is an investment to obtain customer information. This may be misleading in that someone may think a financial institution that acquired a set of information management software and would therefore be doing relationship banking (Also see Chapter 1 page 5-6). This definition focuses on individual customers and their profitability. Nevertheless, financial institutions need to evaluate market share, customer share, profit and risk. For a large corporate customer or a large project, the financial institutions gain their customer share and provide funds such as a syndicate loan to share the risk. The profitability is always relative to risk and therefore it is important to balance risk and return.

Traditionally, the main part of banking is lending. Relationship banking has become synonymous with relationship lending (Freixas, 2005). Relationship lending is defined as a long-term implicit contract between a bank and its debtor (Elsas, 2005). It may be a misunderstanding if relationship banking is defined as a long-term implicit contract. Today, relationship banking represents a strategic area of business that may assure a bank significant comparative advantages compared to both transaction-based banks and other financial institutions (Ferri and Messori, 2000). Relationship banking is a strategic choice of banks to do business (Cameron, 2003) instead of an investment or a contract. Because of these problems of the existing definition **a suitable definition of relationship banking is needed to get a better understanding of the phenomenon[13].**

Relationship banking as a strategic issue requires a strong commitment of bank executives, a clear definition of profit center (customers or transactions), a precise identification of relationship oriented segments, a decentralization of authorities to match relationship responsibilities and a stronger coordination between functions and departments interacting with the firm (Pezzetti, 2004). Therefore this dissertation

[13] A definition of relationship banking for this thesis is provided in Chapter 1 and discussed in detail in Chapter 7.

conducts research so as to investigate **how banks organise and compensate relationship managers (Q3)?**

In the literature, the reasons why firms choose to establish long-term relationships with financial institutions have not been analysed extensively. Aoki and Dinc (1997) argue that relationship financing represents an implicit commitment by banks for additional financing to liquidity-constrained or financially distressed firms. Degryse and Ongena (2001) noticed that, in a recession, firms might prefer to solve their expected financial problems privately in a credit relationship, rather than damaging their reputation on the financial markets. This argument implies that firms expect that the long-term relationships with banks may help them to resolve financial problems during bad times. Campbell (1979) mentions that the confidentiality of a bank relationship may also further facilitate screening and monitoring. The firms value the screening monitoring function of banks that reduce agency cost and improve management efficiency. Morover, Yosha (1995), von Rheinbaben and Ruckes (1998) argues that the close relationship with banks may prevent leakage of firm's proprietary information to product market competitors and may encourage investment in Research and Development (Bhattacharya and Chiesa, 1995). Furthermore most of the research focuses on the bank relationships of small firms. Berger and Udell (1995) and Blackwell and Winters (1997) investigates the value of bank relationship for small firms in the U.S. meanwhile Degryse and Van Cayseele (2000) apply it to small firms in Europe. Because of gaps in the literature, more research is needed to investigate the value of bank relationships for the large corporations. This study investigates these problems by asking the interviewees **why banks establish long-term relationships with corporate customers (Q1).**

Nevertheless, some reasons for financial institutions establishing close relationship with corporate clients were identified in the literature. The subject of informational asymmetries is the basic reason for the existence of the bank-firm relationship and financial intermediaries in general (Freixas and Rochet, 1997). It is important for financial institutions to gather information about the credit worthiness of the borrower. One of the best ways to obtain this information is the development of long-term relationships with them. This allows the lender to gather relevant information

about the prospects and the creditworthiness of the borrower over a considerable time period (Elyasiani and Goldberg, 2004). The continuous contact between financial institutions and their corporate customers produce valuable input for the lender in making decisions on whether to grant funds, how to price loans, and whether to require collateral or attach other conditions to the loan. However, **little study has been done to investigate how bank managers communicate with corporate customers and collect information in relationship banking (Holland, 1993, 1994). Therefore more field research is needed to identify what they are doing in relationship banking**

Moreover, financial intermediation carried out by banks when they lend money to firms leads financial companies to deploy monitoring and supervisory activities (Benston and Smith, 1976; Diamond 1984). These functions reduce agency problems such as conflict of interests (Jensen and Mecklin, 1976). Aoki and Patrick (1994) argues that information of corporate clients is produced through stages of monitoring. Monitoring by stage includes: ex ante monitoring (evaluating the risk characteristics of a borrower's project before the initial financing); interim monitoring (watching over the borrowing firms after the initial funding to ensure that the borrowers can repay their debts); and ex post monitoring (closely examining the borrowing firms when they show signs of distress and working out a restructuring plan if necessary). Along with these monitoring stages, a long-term relationship is established. Nevertheless, **Agency Theory (Jensen and Mecklin, 1976) cannot explain the trust-based long-term relationships between banks and corporate customers.**

Furthermore, Holland (1993, 1994, 2001) noticed that close corporate relationships between firms and their banks were fashioned in a competitive corporate banking market for a wide range of financial services. It implies that banks establish close relationships to respond to the increased competition in the market and therefore greater competition may induce more relationship banking. Aoki and Dinc (1997) discuss whether or not relationship banking may survive in the increased competition. Yafeh and Yosha (2001) suggest that increased (potential) competition in the financial services may strengthen bank-firm relationships. In addition, the banks learn more through repeated economic exchange between banks and corporate clients and

this learning can be magnified if the customers used a range of services (Rajan, 1998). Boot and Thakor (1997, 2000), Yosha (1995) and Rajan (1998) argue that universal banks have information and knowledge advantages in the competition of underwriting with functionally separate banks.

However, Petersen and Rajan (1995) concerned whether increased competition in the financial services industry will destroy bank-firm relationships. They promote the idea that market power is a necessary condition for financial intermediaries to invest in relationships with their client firms. Without market power, banks would not be able to extract rents generated by investment in ties with firms, and consequently there would be little or no relationship banking. Boot and Thakor (2000) argue that an increase in competition among banks results in more relationship lending, while an increase in competition in financial markets result in less relationship lending. Boot (2000) notices that the proliferation of transaction-oriented banking (trading) and direct funding available in the financial markets has started to seriously challenge banks' future as relationship bankers. Yafeh and Yosha (2001) address the same issues obtaining similar results in a different framework. Ergungor (2005) argues that competitive pressures will lower the risk-adjusted profitability of relationship loans.

In general, the literature is very fragmented and no theory is comprehensive related to relationship banking. Some theories such as information asymmetry, agency theory may explain some items in relationship banking but they are not a complete theory of relationship banking. Some arguments are even contradictory and therefore more research is needed and an integrated theory of relationship banking is necessary. This study investigates the factors that influence the development of relationship banking. Furthermore, this study investigates how banks mitigate the competition by relationship banking because this is not well discussed in the literature.

2.4 The benefits of relationship banking

Relationship banking provides benefits to both banks and corporate clients. In the literature, banks mainly benefit from informational advantages through access to private, firm-specific information and maximize the profitability of the customer

relationships over time. The firms benefit mainly from better credit availability and better terms of credit. The following sections discuss these benefits in detail.

2.4.1 The benefits of relationship banking for firms

Many studies investigate how relationship banking create value for the customers and what benefits corporate customers gain in relationship banking. Holland (1993) identifies 10 advantages to companies from relationship banking:

- Funds and services available at short notice to take advantage of opportunities
- Funds and services available at "good" prices when credit or other services are scarce
- Funds and services available when the firm is in distress or has acute needs
- Quick reaction to corporate needs via informal channels which involve less formal (including legal) mechanisms
- Breadth of supply of services especially exotic or unusual services
- Better than market rates for some transactions
- Privileged access to rationed (financial transaction) opportunities
- Banks as a major source of new ideas, new funding and services sources
- Banks as a source of new treasury ideas and financial engineering skills
- Fair pricing of innovative ideas whenever they arise.

The first benefit that firms gain from relationship banking is funds availability. Relationship facilitates the exchange of information between the bank and the firm and thereby help to mitigate some of the inefficiencies associated with single transactions. The lack of information impedes a firm's access to funds due to credit rationing (Stiglitz and Weiss, 1981). Roosa (1951) discusses the effect of the bank-customer relationship in the context of credit rationing. Relationship banking may be able to overcome this through the bank's ability to acquire the necessary information (Petersen and Rajan, 1994). A borrower might reveal proprietary information to its bank that it would never have disseminated to the financial markets (Bhattacharya and Chiesa, 1995). By establishing an intense relationship with borrower, banks may be able to reduce the extent of information asymmetries and, thus, diminish credit constraints for borrower. Relationship lending could permit the funding of loans that

are not profitable for the bank from a short-term perspective but may be profitable if the relationship with the borrower lasts long enough (Boot 2000). If repeated lending from a reputable financial institution provides credible certification and control of managers' actions, a credit relationship may also bolster the firm's reputation (Degryse and Ongena, 2001) and therefore facilitate financing in the capital market (Diamond, 1991).

Berger and Udell (2002) emphasize the link between relationship banking and credit availability and conclude that current literature do not give us a definitive answer. Petersen and Rajan (1994) find that a relationship with an institutional lender increases the availability of financing to a small business. Petersen and Rajan (1995) find that lenders tend to provide more credit to long-term relationship firms in more concentrated banking markets. Berger and Udell (1995) suggest that large banks supply relatively less credit to small "relationship borrowers". Cole (1998) examines the effect of relationships on the availability of credit and finds that lenders are more likely to extend credit if they have a pre-existing relationship with a borrower. Shin and Kolari (2004) suggest that the Japanese main banks have an advantage in acquiring information about client firms and providing more relationship loans relative to other banks. Cole, Goldberg, and White (2004) show that the large banks (US$ 1 billion or more in assets) are more likely to approve a loan to large companies with formal financial records. Small banks use a more discretionary approach and rely more heavily upon appropriate information through pre-existing relationships. Berger, Miller, Petersen, Rajan, and Stein (2002) find similar result that relationships appear to be more important for small banks and small businesses. However, Degryse and Van Cayseele (2000) find a negative correlation between relationship duration and credit availability.

A special issue that needs to be mentioned is that the contribution of relationship banking to the development of emerging industry. There are firms with very high growth potential, often in knowledge-intensive high tech industries, which principally access the private equity markets for early-phase financing. Because these high risk firms generally require large injections of external funding relative to insider financing, have little in the way of tangible assets that may be pledged as collateral,

and are subject to significant moral hazard opportunities to change projects, they are ill suited for bank financing and thus tend to have low levels of leverage (Carpenter and Petersen, 2002). First the return to high-tech investment is skewed and highly uncertain. Second, high-tech investments are difficult to evaluate and frequently embody new knowledge, insiders will have much better information than outsiders about the prospects of firm's investments. Third, high-tech investments often have limited collateral value. Venture capital is the form of equity financing that is currently best suited in the financing of young high-tech companies (Carpenter and Petersen, 2002). Another powerful technology available to reduce information problems in these firms' finance is "relationship lending." Under relationship lending, banks acquire information over time through contact with the firm, its owner, and its local community on a variety of dimensions and use this information in their decisions about the availability and terms of credit to the firm. Petersen and Rajan (1994, 1995) find that relationship banking increased availability of funds to "young" firms because of intertemporal smoothing of contract terms. Recent empirical evidence provides support for the importance of a bank relationship to small businesses in terms of both credit availability and credit terms such as loan interest rates and collateral requirements (Berger and Udell, 2002).

The second benefit is service availability. Relationship banking entails the development of the expertise and the infrastructure for providing value-enhancing services to borrowers (Boot and Thakor, 2000). Because of financial deregulation commercial banks are permitted to undertake investment-banking services, they can continue to utilize their private information about corporate clients and provide investment-banking services to them. In a universal banking system as adopted in Germany and other continental European countries, banks offer a full range of commercial and investment banking services including underwriting, holding and trading on their own accounts, brokerage, and securities custody business. They also sell insurance, mortgages, and investment funds usually through affiliates (Fohlin, 1999). Firms can realize cost savings from relationship banking by bundling their purchases and dealing with a single supplier. Firms avoid the costs of seeking out and conveying relevant information to additional intermediaries.

The third benefit is that the firms may achieve better prices and collateral in relationship banking. Berger and Udell (2002) argues that lenders may charge higher rates to borrowers who are less likely to repay loans and require more collateral or guarantees to improve the terms of the loan for the borrowers. Cole et al. (2004) find evidence that collateralization has a positive effect on loan availability. Firms may benefit from a long-term bank relationship to access to capital at a lower cost and/or with less collateral. Boot and Thakor (1994) predict that, as a relationship matures, interest rates decrease and collateral requirements decline. However, Rajan (1992), Sharpe (1990) and Wilson (1993) predict that interest rates will increase as the relationship lengthens since lenders subsidize the borrowers initially but will be reimbursed with higher rates later.

The empirical studies also have different results. Bodenhorn (2003) shows that firms with an extended relationship with a bank achieve lower credit costs. Scott and Dunkelberg (2003) find that the incidence of collateral is negatively and significantly related to the length of relationship. Berger and Udell (1995) show that lenders offer firms with longer relationships lower rates and are less likely to require collateral. Fernando, Chakraborty and Mallick, (2002) find that the credit limit extended by the lender increases with the length of the borrower-lender relationship but when the relationships exceed 5 years, an additional year of relationship adds no statistically significant benefit in terms of credit limit. Petersen and Rajan (1994, 1995) find that relationships reduce the cost of borrowing slightly but this effect is statistically insignificant. However, Blackwell and Winters (1997) study the strength of the bank-firm relationship show that the length of the relationship is negatively related to the cost of credit. Degryse and Cayseele (2000), Elsas et al. (2004) report that the breadth of the relationship, as a measure of strength, is negatively related to the cost of credit. Elsas and Krahnen (2002) find that in the house bank context relationship banks actually require more collateral than normal banks. Degryse and van Cayseele (2000), Machauer and Weber (1998) find that the probability of pledging collateral increases if the bank is considered as a main bank. Degryse and Cayseele (2000) show that there is a positive correlation between relationship duration and loan interest rate but the scope of the relationship is negatively related to the interest rate. Moreover, they document that relationship scope is a stronger determinant of relationship strength

than duration, in terms of the cost of credit. Berger and Udell (1995) find that large banks charge lower loan rates and require less collateral than do small banks. Small banks that rely more on relationships charge high loan rates and require more collateral because small banks lend heavily to small firms with high risk.

The fourth benefit to firms is that relationship banking leaves room for flexibility of lending contracts (Schmeits, 1999) and thereby enables implicit long-term contracting (von Thadden, 1995). Bank loans are generally easier to renegotiate than bond issues or other public capital market funding vehicles (Berlin and Mester 1992, Dennis and Mullineaux 1999). A credit relationship may foster ex-ante flexibility in writing loan contracts and allow a firm to fulfill its more complex and non-standard credit needs (Boot and Thakor, 1994; von Thadden, 1995). When firms experience difficulties to meet the contracted loan payments, relationship banks may reschedule capital payments through for example overdraft facilities and the possibility of renegotiation and even new lending (Chemmanur and Fulghieri, 1994). Having a long-term relationship with the firm, the bank may have the ability to exert control over the management of firm assets, which may induce managers to take optimal decisions (Rajan, 1992).

The fifth benefit is that firms receive financial support when they are under financial distress (Hoshi, Kashyap and Scharfstein 1990; Edwards and Fischer, 1994). Perhaps the most important benefit from the corporate customer's viewpoint is the bank's implicit commitment to provide ongoing credit and assistance. In effect, this commitment is an insurance policy, assuring the customer of access to credit during periods of restricted availability or financial distress (Moriarty et al, 1983). In a recession, firms may prefer to solve their expected financial problems privately in a credit relationship, rather than damaging their reputation on the financial markets. Bodenhorn (2003) shows that firms with an extended relationship with a bank have loan terms renegotiated during a credit crunch. Hoshi et al. (1990) observe that relationships bank takes on a crisis intervention role and try to rescue the distressed firm. Miwa and Ramseyer (2003) investigated the Japanese main bank system figures and found that the main bank rescued the firm if it fell into financial distress. Using a special database of credit bureau micro-information covering the pervasive financial

crisis in Korea experienced during 1997-1998, Ferri et al. (2001) provided substantive evidence that relationship banking does increase credit availability for SMEs and such role is even more important during financial crises. Elsas and Krahanan (1998) find the German house banks do provide liquidity insurance in situations of unexpected deterioration of borrower ratings. Rajan and Zingales (1998) and Petersen and Rajan (1995) mention that relationship banks offers an implicit agreement to provide below-market financing when their corporate customers get into trouble.

2.4.2 The benefits of relationship banking for banks

While a number of theoretical and empirical studies have documented benefits of relationship banking to firms, not much is known about benefits for banks (Bharath, Dahiya, Saunders and Srinivasan, 2004). In the literature, information and knowledge advantages are the main benefits of relationship banking to the banks (Boot, 2000). A firm might reveal proprietary information to its bank that it would never have disseminated to the financial markets (Bhattacharya and Chiesa, 1995). Conceptually, relationship banking is based on private information. Transactional banking, on the other hand, is considered as "arms length" financing and based on public information. The role of private, firm-specific information is one of the key issues behind relationship banking.

Relationship banking facilitates a continuous flow of information between firms and banks and gives access to private information that tends to remains confidential. Relationship banking has advantages in gathering/producing information about their clients. There are economies of scale: the cost of information gathering/production is reduced by learning through repeated transactions (Nam, 2004). Moreover, there may be economies of scope: banks can utilize the information obtained through a number of products and services (Petersen and Rajan, 1994).

Relationship banking provides other benefits for banks include controlling costs, increased profitability and stable growth (Kalwani and Narakesari, 1995). Banks may improve profitability by reserving relationship lending for loan for large size (Stanton, 2002). Kotler and Armstrong (1999) suggest that banks can obtain higher

sales and earn greater returns from maintaining long-term relationships. Noordewier et al. (1990) indicate that relationship banking increase the performance outcomes. Moreover, Ricard and Perrien (1999) found that relationship practices have a direct impact on customer loyalty. Relationships between banks and borrowers also may have positive effects on the reputations of the bank because of the increases in lending and underwriting market share (Colgate and Lang, 2001). Ferri, Kang and Kim (2001), Hoshi and Patrick (2000) propose that relationship banking reduces monitoring costs, decreases loss from debt failure, and mitigates conflicts of interest between the bank and shareholders through the holding of corporate shares.

Moreover, Nam (2004) argues that relationship lenders have a higher probability of selling future information-sensitive products (e.g. loans, security underwriting, etc.) to its borrowers compared to a non-relationship lender. Drucker and Puri (2004) and Yasuda (2005) show that past lending relationships facilitate the banks to win future investment banking business such as public debt underwriting. Kanatas and Qi (2003) predict in their model that the benefits of scope economies that arise when a single institution offers both lending and underwriting services to same customers. Further benefits of relationship banking are that the relationship banks may charge higher prices for loans (Rajan, 1992; Sharpe, 1990). However, Sharpe (1990) argues that banks may not charge higher rates in order to build their reputation as "non-exploiting" lenders and attract future borrowers.

2.5 The cost of relationship banking

However, the literature also suggests that there are costs associated with relationship banking. Sharpe (1990), Rajan (1992) and Boot (2000) notice the so-called "hold-up problem" and "soft budget constraint" associated to relationship banking. The relationship bank has confidential information about the client firm and this information monopoly may allow the bank to charge ex post high loan interest rates. The client firms have switching costs, as the substitution of the relationship bank is a time consuming and resource consuming process. Moreover, the relationship bank may not be able to deny additional credit to a customer firm as in the past it has already loaned money to a firm may well decide to extend further credit to the same

borrower in the hope of recovering the previous loans. Furthermore, the borrowers can be induced to exert insufficient efforts in preventing a bad outcome from happening when they realize that they can easily renegotiate their contract ex post.

The literature shows that the extent to that bank can exploit an information monopoly is unclear (Farinha and Santos, 2001; Ongena and Smith, 2001). Weinstein and Yafeh (1998) find that Japanese banks extract rents by charging relatively high interest rates to firms with which they have a close relationship. Degryse and van Cayseele (2000) find hold-up problems that bank does not transfer mutual benefits to the firm. Nam (2004) tests if relationship lending is associated with higher prices of future loans and services. His results show that relationship loans carry lower costs and equity-underwriting fees are lower for IPOs. However, he finds that fees for debt underwriting are higher for relationship borrowers. Angelini, Di Salvo, and Ferri (1998) find that at Italian banks loan rates tend to increase with the length of relationship. Degryse and Van Cayseele (2000) find that the loan rate increases with the length of the relationship but loan rates decline with the scope of the relationship and the scope effect outweighs the duration effect. The relationship bank rescues the distressed firm (Hoshi et al., 1990; Miwa and Ramseyer, 2003), or renegotiates the loan term during a credit crunch (Bodenhorn, 2003), which implies the existence of soft-budget constraint.

Sharpe (1990) proposes that the bank's monopoly power can be mitigated by the bank's desire to acquire a reputation for refraining from extracting monopoly holdup rents. Another solution to the holdup problem is that a firm establishes more than one inside bank relationships and thus have the banks compete away the monopoly rents (Rajan, 1992; von Thadden, 1998). But this may reduce relationship benefits such as the availability of credit for the firm (Petersen and Rajan, 1995).

In conclusion, the literature is very fragmented in terms of the benefits of relationship banking for banks and corporate customers and the empirical findings are inconclusive. No complete study has been done to systematically investigate the outcomes of relationship banking. In particular, except the overall information advantages, the existing work falls short in that it has not identified the precise

benefits of relationship banking for banks (Boot, 2000). Therefore this study investigates **how banks and corporate customers get benefits from relationship banking (Q5) from banks' point of view by interviewing bank relationship managers?**

2.6 Measuring the strength of banking relationship

The literature suggests that stronger relationships may overcome or at least decrease the problems caused by informational asymmetries, such as adverse selection and moral hazard. Therefore many studies try to measure the strength of the bank-firm relationship. Moreover, some empirical studies have tried to link the strength of a bank-corporate relationship and the added value of relationship banking. The following section reviews the literature of measuring the strength of bank relationships in terms of the duration, scope, intensity, and number.

2.6.1 The Duration of relationships

Typically, the strength is measured by the duration of the bank-corporate relationship. The duration is important because information is accumulated and sharpened through repeated interactions. Moreover, commitment and reputation are also built and verified over time. Risk-sharing and other compensatory pricing practices often take place over the cycles of firm growth and profitability (Nam, 2004). The measure of duration has generally been criticized because the duration indicates only the length of the relationship and does not measure strength in terms of the intensity of the relationship (Elsas and Krahnen 1998, for instance).

Some studies investigate the length of bank-corporate relationship in different areas. Elsas and Krahnen (1998) estimate the mean duration of a bank relationship in their sample of German companies to be 20 years, while in Horiuchi, Packer and Fukuda (1988), the estimate for Japanese firms is between 21 and 30 years. The estimates from Norway and Sweden are of the same order of magnitude. In contrast, most of the US estimates of duration are less than ten years. Cole (1998), for example, finds the mean duration of US firms in his sample to be seven years. Nevertheless, Harhoff

and Körting (1998) report the average duration of a bank relationship to be around twelve years, an estimate from the US data. Berger and Udell (1998) use the 1993 National Survey of Small Business Finance (NSSBF) to indicate that the average length of relationship between small business firms and commercial banks is 7.77 years. Using the same survey data, Cole, Goldberg, and White (2004) find that the average length of relationship with the bank to which the firm applied for credit was 7.80 years. The inconsistence may be due to the data vary greatly according to the characteristics of the sample firms and by how duration is estimated (Ongena and Smith, 1998). These findings are consistent with the idea that Japan and continental European countries tend to be bank-dominated economies, where relationship-based financing plays a dominant role (Cable, 1985; Aoki and Patrick, 1994).

The determinants of bank relationship duration include the size, age and other characters of the firms (Ongena and Smith, 1998). Moreover, the long-standing bank relationships are more likely to be terminated than shorter relationships (Greenbaum et al., 1989), which also imply that the value to the bank of a relationship decreases as the relationship lengthens. Ongena and Smith (1998) report that bank relationships tend to be shorter for small, young, and relatively high-leveraged firms and suggest that those firms most in need of bank financing maintain relationships for relatively shorter periods of time. Furthermore, Ongena and Smith (1998) report that firms that maintain multiple simultaneous bank relationships end a given bank relationship sooner than a firm with one bank relationship.

Some studies link the duration of bank-corporate relationships to some relationship benefits. According to theoretical studies, the duration of the relationship can be either positively (Boot and Thakor 1994) or negatively (Greenbaum, Kanatas and Venezia, 1989; Sharpe, 1990; Wilson, 1993) related to the cost of credit. Boot (2000) asserts that contract terms improve over the length of the relationship with interest rates and collateral requirements falling. Berger and Udell (1995) and Bodenhorn (2003) find that duration does appear to positively influence the availability of bank credit to customers. From a sample of nearly 18,000 loans from one Belgian bank, Degryse and Van Cayseele (2000) document a positive relation between relationship length and contract interest rate. Cole (1998) uses surveys to show that credit

availability increases in the length of the relationship over its first year, but does not increase thereafter. In addition, firms in longer bank relationships are less likely to pledge collateral against the loan. Blackwell and Winters (1997) also find in a sample of small firm loan contracts from 6 U.S. banks that longer relationships lead to lower monitoring frequency, and lower cost of credit.

However, Elsas and Krahnen (1998), drawing from credit file data from large German "house" banks and Harhoff and Körting (1998), using data from a survey of German firms, find no significant impact of duration on cost of credit. Angelini, Di Salvo and Ferri (1998) obtain similar results using a small firm survey from Italy. Degryse and Van Cayseele (2000) are unable to uncover a relation between duration and the probability of pledging collateral in Belgian firms. Cole et al. (2004) also find no significant relationship between length of relationship and the probability of loan approval for all banks, large banks, and small banks. Interestingly, in the European context, Degryse and Van Cayseele (2000) find the opposite: contract terms deteriorate with longer duration of the relationship.

2.6.2 The scope of relationships

The strength of a bank relationship may also be measured by its scope at one point in time. Scope is defined in terms of the breadth of services offered by the bank and utilized by the firm (Ongena and Smith, 1998). In addition to lending, relationship banking include deposit and investment activities, check clearing, cash management and currency exchange services. It also includes investment banking, brokerage, insurance and other financial services. By providing these financial products and services, the bank can draw an adequate and reliable picture of the firm's operational and financial activities, which may assist in deciding on the firm's current or future loan applications (Rajan, 1998). It also provides the bank with additional contracting flexibility and allows the bank to set pricing policies across different services because the fixed cost of producing information about a firm can be spread over multiple products and services (Ongena and Smith, 1998).

The empirical studies of relationship scope find that the availability of credit to the firm if the relationship between the firm and bank includes a broader or more informative use of the financial services offered by the bank (Berlin and Mester, 1998; Cole 1998). Moreover, the loan rate decreases as the scope dimension offers a deeper understanding of the essence of the bank-firm relationship (Cole, 1998; Scott and Dunkelberg, 1999; Degryse and van Cayseele, 2000). In his survey of managers at top commercial banks, Hodgman (1963) finds that managers consider the quality of a deposit relationship to be the most important criterion in deciding whether or not to extend a loan. Petersen and Rajan (1994) control for whether a firm maintains deposits or purchases other non-lending services from its bank interest cost and credit availability. They are unable to uncover a relation between the scope variables and contracted interest costs, but do find that firms that purchase other services from the bank are less credit constrained. Berlin and Mester (1998) present results to suggest that banks with strong market power in deposits are more accommodative with lending. Banks holding a large proportion of a region's core deposits maintain loan contracts that are less sensitive to economic fluctuations. Degryse and Van Cayseele (2000) find that the purchase of other information-sensitive services from a bank lowers the interest rate charged to the customer and Angelini et al. (1998) find that members of cooperative (mutual) banks obtain easier access to credit at lower interest rates than non-members.

2.6.3 The distance of relationships

Some studies investigate the physical distance between banks and client firms as a dimension of the strength of bank-corporate relationships. The distance may be an important factor in bank-corporate relationships because the collection of soft information usually requires contact between banks and client firms. The communicating is facilitated by geographic proximity. The geographically close banks would incur lower costs in gathering the required information, and therefore firms would likely receive better terms on loans when they are in close proximity to the bank (Elyasiani and Goldberg, 2004). However, the development of communication and information technology makes the distance of relationships less important than before.

Several studies examine whether distance between lender and borrower has been changing over time. Petersen and Rajan (2002) find that distance has increased. Berger et al. (2002) explain their finding that older firms are located closer to their banks because when they started their relationship little hard public information was available about them. Petersen and Rajan (2002), Degryse and Ongena (2005) document that the distance between the lender and borrower has increased in recent years and communication between them has become more impersonal. Petersen and Rajan (2002) analyze whether this impersonal communication can be explained by the distance between the lender and the borrower. Their results do not support this argument.

However, in a study of a large Belgian bank, Degryse and Ongena (2005) find that distance did not increase from 1975 to 1997. Brevoort and Hannan (2004) find for local borrowers in the US that there has been no discernable increase in distance between lenders and borrowers. The changes in technology that could give rise to increasing distances appear to have been adopted only by a small group of banks.

Some theoretical models are developed to analyze the distance of bank-corporate relationships and link it to funds availability and loan prices. Grossman and Shapiro (1984) propose that customers buy a product from a particular seller upon becoming informed of its location through advertising. The advertising itself is not localized. The sales price in their model exceeds the full information price, by the magnitude of the transportation cost, as informational differentiation lowers the elasticity of demand. In addition, consumers in their model, as they are unaware of all sellers, do not necessarily patronize the closest one. Elliehausen and Wolken (1990) document that small- and medium-sized firms in the United States are influenced by other characteristics of the branches (convenience and hours of operation), banks (reputation, quality, and reliability), and relationships (personal or long-term) when choosing a particular bank. Hence, firms may not visit the closest bank branch when another bank's loan product exhibits other, more preferred characteristics (Pinkse, Slade, and Brett, 2002). And once borrowers have experienced a good match and have observed the high quality of the services provided by their current bank, they

switch to another bank only when it offers a considerably lower price (Tirole, 1988). Bester and Petrakis (1995) model the advertising of lower price offers. In the absence of advertising, customers are only informed about local prices. In addition, producers advertise lower prices to attract customers from more distant locations. Hence, more distant informed customers are observed to receive lower prices. Hauswald and Marquez (2003) develop a model in which the precision of the signal about a borrower's quality received by a bank decreases with distance. Because banks receive more precise signals about close borrowers, the informed relationship bank can charge higher interest rates to closer borrowers. Therefore there is a negative (positive) relationship between the loan rate and the distance between the borrower and the relationship bank. Petersen and Rajan (1995) also argue that banks located closer to borrowing firms enjoy significantly lower transportation and monitoring costs, to such an extent that if other banks are relatively far, close banks have considerable market power.

Some empirical studies investigate the correlation between the distance of relationships and funds availability and contract terms. Degryse and Ongena (2005) find that credit availability for distant firms has increased over time. Furthermore, they find that loan rates and distance between the firm and the lending bank are negatively related. Cole et al. (2004) find that distance is not related to the loan approval decision. Degryse and Ongena (2005) investigate 15,000 loans at a bank in Belgium and find that loan rates decrease as distance between lender and borrower increases. Brevoort and Hannan (2004) empirically estimate the relationship between distance and commercial lending and find that distance is negatively associated with the likelihood of a local commercial loan being made. They find no evidence that distance is becoming less important in the United States in recent years. In fact, the bulk of the evidence suggests that distance may be of increasing importance in local market lending.

2.6.4 The intensity of relationships

In the literature, the intensity is another dimension to measure the strength of bank-corporate relationships. The relationships between banks and corporate customers

maybe more intensive if the communication between a bank and corporate customer extend beyond banking activities such as the banks hold shares or appoint directors in the board of client firms or they cross hold equities or share board numbers. Lewis (1996) argues that a bank can exert direct, ownership type control over a firm by participating in an external supervisory role or by holding voting equity in the firm. The literature places particular emphasis on the so-called "main" banks in Japan and "house" banks in Germany. A Japanese main bank provides debt financing to the firm, owns some of its equity, and may even place bank executives in top management positions (Hoshi, Kashyap and Scharfstein, 1990). A German house bank is defined as the premier lender of a firm, being equipped with more relevant and, more timely information than any normal, non-house bank (Elsas and Krahnen, 1998). Moreover, Van Ees and Garretsen (1994) find that about half of their sample firms in Netherlands between 1984 and 1990 share board members with their banks. Angelini et al (1998) document that Italian local cooperative banks have cooperative ownership in some firms. Berglöf and Sjögren (1995) find that Swedish banks indirectly own part of the firms and maintain interlocking directorates. Overall, banks are often conjectured to play a much less dominant role in corporate finance in the US, Canada, and UK, than in Continental Europe and Japan (Ongena and Smith, 1998).

A growing literature discuses the merits and drawbacks of intensified bank-corporate relationships (Macey and Miller, 1995). The winter 1997 issue of the Journal of Applied Corporate Finance reviews recent published debates on the subject. Kracaw and Zenner (1998) argue that this provides an extra mechanism for the bank to facilitate information transfer and control managerial decision-making. This degree of control may enhance the benefits of the relationship by, for example, strengthening a bank's commitment to be accommodative during difficult financial times, but may also accentuate a bank's monopoly power over the firm. In addition, this alleviates potential conflicts of interest between creditors and equity holders and the associated problems of asset substitution, and under- or over-investment (Jensen and Meckling, 1976; Myers, 1977). However, Morck and Shivdasani (2000) propose some problems from these intensified relationships. First, if the client firms of a shareholder-bank face smaller credit constraints, these soft-budget constraints can lead to investment

inefficiency. Second, the shareholder bank might use its stronger voice to distort corporate decisions to protect its own interests as a creditor (by discouraging risky but firm-value-increasing projects). This is a result of the fact that banks' equity stakes in client firms are usually much smaller than their stakes as creditors. Finally, a shareholder-bank's power over its client firms can lead to the extraction of increased rents.

Some empirical studies provide evidences both for the benefits and problems of holding firm shares and keeping positions in the board. Gorton and Schmid (1996) find the positive impact of equity-holding banks on the performance of Germans firms. Elsas and Krahnen (1998) compare the contract terms and credit availability of house banks versus normal banks in Germany. They find that house banks provide flexible conditions to customers. Fukuda and Hirota, (1996) find that Japanese main bank relationships reduce debt capacity constraints. Flath (1993) finds that Japanese firms with a main bank receive more loans, less collateral, have greater prospects of growth and spend more on research and development. Lichtenberg and Pushner (1994) find that the block holding of corporate equity shares by financial institutions is associated with better corporate performance. Prowse (1995) also finds that banks' shareholdings are significantly correlated with their lending to the firm especially for firms operating in relatively risky environments. This complementarity between equity and debt holding by banks can be interpreted as a result of banks' attempts to protect their position as lenders, or the result of mitigated agency problems.

However, according to a survey on cross-shareholding with financial institutions conducted on Japanese exchange-listed companies, few firms regard the cross-shareholdings as beneficial in terms of financing (lower borrowing interest rates or increased availability), but most expect support during financial distress and believe the cross-shareholding will be continued in the future (Wakasugi, Omura, and Miyashita, 1994). Kracaw and Zenner (1998) indicate that firms have suffered from the increased control that the bank has attained. Weinstein and Yafeh (1998) report that Japanese firms with main bank relationships face higher interest charges and experience slower growth rates than non-main bank firms. Nitta (2000) finds stable shareholdings, especially those by banks and cross-shareholdings with non-financial

companies, have a negative influence on corporate performance. Kracaw and Zenner (1998) examine the US stock price reactions to banks loans and find that lower price reactions at the announcement of an interlocked bank loan. They interpret their results as implying that strong board interlocks intensify hold up problems.

2.6.5 The number of banking relationships

In the relationship banking literature, many studies investigate the number of banking relationships of firms. Borrowing from a single lender, or loan concentration, is considered to represent a strong relationship compared with multiple banking relationships. Because the level of mutual commitment is high and the scope of the relationship is also likely to be large in a single bank relationship (Rheinbaben and Ruckes, 2004). Therefore the number of banking relationship may be another dimension to measure the strength of bank-corporate relationships.

Some scholars explain the existence of single bank relationships and multiple bank relationships. A single bank relationship arises as the optimal mechanism for channelling loans from investors to firms when costly information asymmetries exist between the investors and project insiders (Diamond, 1984). In the presence of hold-up costs, one bank relationship may no longer be optimal. When a firm maintains multiple bank relationships, it can improve the terms of its financial contracts by forcing banks to compete. By inviting competition from other banks, a firm can reduce the possibility for its incumbent bank to extract monopoly rents. Detragiache et al. (2000) argue that the optimal choice of number of bank relationships is shown to be a function of the fragility of a country's banking system and the efficiency of its bankruptcy process. In a country with a fluctuated economy, firms have an incentive to insure themselves against a bank loss by investing in more than one bank relationship.

Some empirical studies investigate the average number of bank relationships across different countries. For the 20 European countries, Ongena and Smith (1998) find large variation across data sets although multiple-bank relationships are a common feature to nearly all of the data sets. Firms in the UK, Norway and Sweden maintain

relatively few bank relationships - less than three on average -while firms in Italy, Portugal, Belgium and Spain maintain on average ten or more bank relationships. Moreover, Small firms tend to maintain fewer bank relationships than studies large firms. Detragiache, Garella, and Guiso (2000) show that Firms in Italy have greater number of relationships with banks as compared to the United States. Farinha and Santos (2000) show that the majority of firms borrow for the first time from a single bank, but soon afterwards some of them start borrowing from several banks. Firms with more growth opportunities and more bank debt and less liquidity are more likely to initiate multiple relationships. Firms with poor performance, too, are more likely to initiate multiple relationships. Rheinbaben and Ruckes (2004) argue that it is optimal to have a substantial number of creditors to induce competition among them. In addition, the highly rated companies tend to deal with many creditors and disclose little private information. A firm whose initial credit rating is low must disclose a substantial amount of private information and has small or single number of creditors to protect information leakage.

The literature covers a debate on the number of bank relationships. Some studies hold that single bank relationships are more beneficial to the firms. A single-bank relationship has the benefits of reducing information costs (Diamond, 1984), reducing borrowing costs, and avoiding the leakage of private information (Padilla and Pagano, 1997). Diamond argues that a single bank is enough to resolve the problem of information asymmetries. Multiple-bank relationships would merely serve the same function, but make it less effective or more costly. Fork, Chang and Lee (2004) argue that the free-rider problem is lower in the case of a single creditor rather than multiple creditors. A single creditor has a stronger incentive to monitor its borrowers and thus exert a positive impact on the firm's performance. These merits of a single-bank relationship suggest a negative relationship between the number of bank relationships and firm performance (Fork, Chang and Lee, 2004).

Some empirical studies provide evidence to support that single bank relationships are better than multiple relationships. Degryse and Ongena (2001) analyse all Norwegian publicly listed firms for the period 1979-1995, they find that firms with a bilateral relationship are more profitable. Firms that are more profitable more often maintain a

bilateral relationship. Petersen and Rajan (1995) show that borrowing from banks with large market power facilitates inter-temporal sharing of rent surplus and hence increases the value of a single relationship, which is crucial for smaller or younger firms. Ongena and Smith (1998) show that firms with multiple-bank relationships end a bank relationship sooner than single-bank firms, suggesting that a given bank relationship is less valuable to multiple-bank firms. Houston and James (1999) show that the desirability of multiple bank relationships crucially depends on funding needs. In the case of more modest funding needs, single bank firms are less cash flow constrained than firms with multiple bank relations are. Cole (1998) finds multiple-bank firms are denied credit more frequently than single-bank firms and Harhoff and Körting (1998) documents lower availability of credit to multiple-bank firms.

However, some studies find that single bank relationships have negative influence on the firms. Rajan (1992) and von Thadden (1998) claim, a single bank may have monopoly power over information about the borrowing firm and exploit the firm. The information lock-in problem and resulting holdup costs. Houston and James (1999) find that single-bank firms are more sensitive to investment cash flow constraints, hold larger stocks of liquid assets and pay lower dividends. They conclude that single-bank firms are more credit constrained than multiple-bank firms. Houston and James (1996) demonstrate that, for their sample, a single-bank firm's reliance on bank debt is negatively correlated with future growth potential, while the relation between bank debt level and growth for multiple-bank firms is positive. Houston and James (1999) examine a sample of 250 publicly traded firms and find out that publicly traded firms that rely on a single bank are significantly more cash flow constrained than firms that maintain multiple bank relationships or have access to public debt markets.

Some studies try to explain the existence and discuss the benefits of maintaining multiple bank relationships. Ongena and Smith (2001) present that the competing bank relationships reduce the market power of any one bank, making long-term relationship more valuable. Degryse and Ongena (2005) explain the existence of multiple banks that the inability to communicate information or coordinate actions

across banks can be beneficial in inducing optimal behavior on behalf of firm managers. Specifically, decentralized economies prevent commitment to sink financing into long-term projects, because dispersed banks with limited capital do not communicate or coordinate bargaining with each other. Multiple bank relationships may be beneficial if there exists an exogenous chance that a firm will lose a valuable bank relationship, firms may invest in establishing multiple bank relationships to "diversify" the risk of losing its connection to a bank (Detragiache, Garella and Guiso, 1997). Bolton and Scharfstein (1996) argue that borrowing from multiple lenders decreases the incentive for a firm manager to strategically default since the manager must coordinate a restructuring plan with multiple claimants. Bolton and Scharfstein (1996) also predict that multiple bank relationships decrease the default risk of the firm. The lack of coordination between bankers may lead firm managers to diversify the opinions among banks (Dewatripont and Maskin, 1995). Moreover, the use of multiple lenders may be desirable for borrowers because the removal of credit from the firm's only lender may provide a negative signal to the market (Berger and Udell, 1998).

However, many studies propose the drawbacks of multiple bank relationships. Ongena and Smith (2000) argue that multiple bank relationships may deteriorate the availability of credit. The existence of multiple lenders increases price and reduces the availability of credit (Petersen and Rajan, 1994). The explanation is that, since each of the banks that a borrower has relationships with is able to obtain less proprietary information, the value of information acquisition is reduced for each bank and the bank does not have strong incentives to offer better loan term to borrower. Thakor (1996) provides a formal theory that the presence of multiple lenders causes "too much" competition ex post that can discourage lending to young firms (Petersen and Rajan, 1994). Cole et al. (2004) propose the hypothesis that banks prefer to be the sole source of financial services, and that this is more important for large banks that can provide more services. Bolton and Scharfstein (1996) argue that borrowing from multiple sources increases the cost of negotiation when a firm requires project refinancing. Since maintaining relationship with heterogeneous borrowers is difficult and costly, Hauswald and Marquez (2000) argue that banks facing retrenching decisions that leads to sector specialization with rising competitive pressures. An

increase in the number of banks may aggravate an adverse selection problem by enabling lower-quality borrowers to obtain financing, resulting in moral hazard and credit rationing (Petersen and Rajan, 1995) or a higher interest rate (Broecker, 1990). Thakor (1996) has introduced a model to examine the effect of multiple relationships. According to the model, the existence of multiple relationships reduces the value of information acquisition by any one bank.

Some empirical studies provide evidences that multiple bank relationships have drawbacks. Cole (1998) and Harhoff and Korting (1998) find that multiple-bank firms actually have less access to credit than single-bank firms. Petersen and Rajan (1994) find those firms that maintain multiple-bank relationships face higher interest payments and are more credit constrained than single-bank firms are. Angelini, Di Salvo, and Ferri (1998) report a negative effect of the number of bank relationships for a sample of Italian firms. Foglia, Laviola and Reedtz (1998) show that multiple banking relationships are associated with a higher riskiness of the borrowers. When a large number of lenders are involved, monitoring of the borrowers tend to be weaker and encourage fragility in the firms' balance sheets. Weinstein and Yafeh (1998) in a study of performance of main bank clients and independent firms in Japan documenı that main bank clients are less profitable and slower growing than independent firms. Cole et al. (2004) examine the effect of the number of bank relationships on the likelihood of loan approval. The effect of multiple relationships is negative and significant for all banks and for large banks. It is negative but not statistically significant for small banks.

2.6.6 The value of bank-corporate relationships

Some scholars try to calculate the value of bank-corporate relationships. Holland (1994) proposes the Net Present Value of the relationships from the perspective of both banks and firms. He explains the procedure in detail. Firstly, the firm or the bank can assess the costs and benefits of relationships over time. Secondly, by analogy with the investment decision and the net present value model, both parties can discount the net benefits to arrive at a Net Present Value of the relationships. The discount rate can be arrived by considering the riskiness of the net stream of benefits

over time. The riskier the net benefits stream, the higher the discount rate and the lower the value placed on the close relationship (Holland, 1993).

However, there could be some difficulties to employ this method. First, some important benefits and costs of relationship banking are non-monetary factors. For example, the managers in the firm and bank could be happy with a trust-based personal relationship. Second, it is hard to separate the effect of relationship from some other factors such as innovation, advance in technology, on the net stream of benefits. Although Holland (1993) proposes that the value of relationship could be calculated by considering the reduction (if any) in net income and increased variability in income caused by moving from close banking relationships to transactions relations and the associated release (if any) of scarce management time and effort.

Some studies identify the value of bank-corporate relationships by investigating the change of market value of firms and banks involved in close relationships. In the early work of James (1987) and Lummer and McConnell (1989), the focus was on the announcement effect of bank loan agreements on stock prices. In general, this literature shows that there is a positive announcement effect. This announcement effect strongly suggests that banks play a special role and points at a benefit of relationship banking. Similarly, Slovin et al. (1988) show that the announcement of a commercial paper issue has a significantly positive stock price impact only if backed by a stand-by letter of credit from a bank. Hori and Takahashi (2001) evaluate the economic value of Japanese relationship by investigating the stock price reaction against large-scale bank failures in Japan. Their finding seems to roughly support the hypothesis that the Japanese bank relationships has an economic value and main bank failure may cause client firms to incur a large economic loss. Using a large sample of exogenous events that negative affect Korean banks during the 1997-1998 period, Bae et al (2002) show that adverse shocks to banks have a negative effect not only on the value of the bank themselves but also on the value of their client. Djankov et al. (2000) examine the valuation effect of a bank's insolvency on client firms, using a sample of 31 insolvent banks in Indonesia, Korea, and Thailand during 1998-99. They find that for entire sample, the announcement of a bank closure leads to

negative abnormal performance of related firms. Their finding suggests that the continuity of the banking relationship add value to a firm.

However, some other studies provide different results. Ongena et al. (2000) measure the impact of bank distress announcements on the stock prices of firms maintaining a relationship with a distressed bank, using the near collapse of the Norwegian banking system during the 1988-1991 period. They find that the aggregate impact of bank distress on listed firms is small and statistically insignificant. Schenone (2004) investigates the effects of pre-IPO banking relationships on a firm's IPO. The results show that firms with a pre-IPO banking relationship with a prospective underwriter face about 17% lower underpricing than firms without such banking relationships. Limpaphayom and Polwitoon, (2004) examines the relation between bank relations and market performance in Thailand. They find there is a negative relation between lending relationships and market performance indicating that bank lending may not always be consistent with value maximization and bank relationships are not always beneficial to the firm.

There could be some problems in utilizing stock market response to identify the value of bank-corporate relationships. First, this method assumes that the stock market is efficient and correctly reflects the change of firm value. Second, it is hard to separate the influence of bank-corporate relationship and other factors. Third, the stock market shows the change or the trend of the value of relationships instead of an absolute figure.

The literature is very fragmented in measuring relationship banking. None of these methods are complete to measure bank-corporate relationships and relationship banking performance. This dissertation conducts research to investigate how **banks measure relationship-banking performance (Q4)?**

2.7 Conclusion

This chapter reviewed the literature in relationship banking including the role of bank in financial market and bank-corporate relationship in corporate banking. The

concepts of bank-corporate relationship were discussed but the nature of bank-corporate relationship and the relationship banking process are missing in the literature. Relationship banking is a growing area of research (Elyasiani and Goldberg, 2004). However, the term relationship banking is not rigorously defined in the literature (Freixas, 2005). There are misunderstandings of relationship banking. For instance, Boot's (2000) definition implies that relationship banking is an investment to obtain customer information. This may cause a misunderstanding that relationship banking is only about making investment in customer information management. Freixas (2005) documents relationship banking as relationship lending and Elsas (2005) considers relationship banking as a long-term implicit contract between a bank and its debtor. These studies revealed that the relationship banking is understood improperly or incompletely.

In practice, relationship banking is a strategic choice of banks to do business with corporate customers (Cameron, 2003). Relationship banking is employed as a business strategy to gain competitive advantages (Ferri and Messori, 2000). However, how banks or financial institutions utilize a relationship-banking strategy to create competitive advantage has not been systematically researched (Pezzetti, 2004).

The benefits of relationship banking are not systematically discussed in the literature. In particular, the benefits of relationship banking for banks were not well explored. It is necessary to investigate the benefits of relationship banking for both banks and corporate customers. This study more focuses on bank side and therefore the bank relationship managers are interviewed.

This chapter also reviewed the measurements of the bank-corporate relationship and relationship banking performance. However, existing work falls short in that it has not measured the precise sources of the added value of relationship banking (Boot, 2000). Moreover, in practice, the proposed theoretical methods were not widely employed. For example, it is hard to calculate the lifetime value (LTV) of a customer because the duration of the relationship and the accurate income from the customer are not easy to predict.

The high level abstract theories such as information asymmetry and agency theory can explain some items of relationship banking but they are not comprehensive and relative to relationship banking. Sometimes there may be conflicts in ideas. For example both banks and companies need relationship banking to overcome agency problems, however, trust-based long-term relationships are impossible to be established because of agency problems. Therefore a grounded theory is needed to understand the phenomenon in an integrated manner. A grounded theory has own theoretical categories, key variables and causal links between these theoretical elements, and provides "saturated" explanation of themes embedded in grounded phenomena. Grounded theory can act as intermediary between "high" theory and phenomena and provides an overall map of relationship banking linking all these themes together. Moreover grounded theory can be used to identify new 'high' theory, new empirical literature, for example organisational theory, strategy and marketing literature, to explain the phenomena. Grounded theory can be seen as a way of linking and integrating wider literature relevant to relationship banking.

In general, much research is needed in the area of relationship banking. There are many unanswered questions and there are contradictory answers to many of the questions already addressed. There are limitations in explaining the phenomenon by employing conventional banking theories. Therefore an in-depth study is necessary to explore this phenomenon to get a better understanding of relationship banking. Furthermore, a grounded theory of relationship banking is needed to integrate and link the relevant theoretical and empirical studies.

The next chapter will discuss the research methodology and research methods. A qualitative research is recommended to obtain the intricate details about a specific phenomenon under investigation. A Grounded Theory (Strauss and Corbin, 1998) is adopted whereby theory is derived from data, systematically gathered and analysed through the research process.

Chapter 3 Research Methodology

3.1 Introduction

The previous chapter critically reviewed the literature on relationship banking and discussed the problems and research opportunities. The literature covered the role of banks in the financial market and the bank-corporate relationship in corporate banking. The concepts of bank-corporate relationship and relationship banking were discussed in the literature but there were some limitations of literature. Some of the benefits and costs of relationship banking were also addressed in the literature but more research is needed. The chapter also reviewed the measurements of the bank-corporate relationship and relationship banking performance. However, the existing work has not measured the precise sources of the added value of relationship banking (Boot, 2000). Therefore the research opportunities were proposed through out the literature review.

This chapter discusses the research methodology adopted throughout this research. The rationale on the selection of the particular methodology is addressed. A Grounded Theory (Strauss and Corbin, 1998) approach is adopted whereby theory is derived from data, which is systematically gathered and analysed. The advantages and limitations stemming from these research choices are also discussed.

3.2 Research methodology

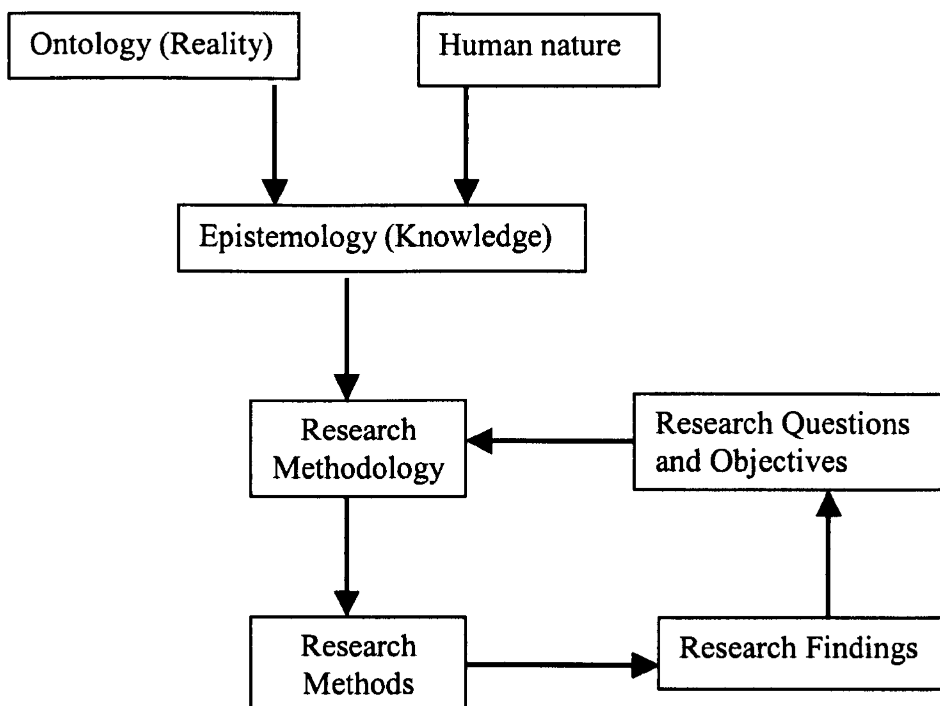
Research methodology refers to the overall approach to the research process, from the theoretical underpinning to the collection and analysis of the data. Research methods, on the other hand, refer only to the various means by which data can be collected and/or analyzed (Hussey and Hussey, 1997). This chapter focuses on the methodological issues and next chapter will discuss the methods utilized in collecting data, processing data and writing up the findings in detail.

Research methodology is dependent upon ontology, which in turn is dependent upon epistemology. Each of these elements is important to this research, and therefore one

must ask the relevant questions: how do we know the world (epistemology)? What is the nature of the reality we are exploring? (Ontology) and how might one gain knowledge of reality through this endeavor? (Methodology). A set of related assumptions are often termed a way of thinking. The following sections address the epistemological and ontological positions of this study and discuss the rationale of these positions adopted in this study.

The selection of research methodology in this study is also discussed. This study believes that the adoption of research methodology is dependent upon the positions on ontology, human nature, epistemology, and research question and research purpose. Epistemology is dependent upon ontology and human nature. In fact human nature is one part of ontology. Figure 3-1 shows the relationships among them. Assumptions on ontology, epistemology, and human nature are fundamental and pre-requisitions for doing research (Laughlin, 1995). Research methodology is a way of thinking about and studying the social reality (Strauss and Corbin, 1998). Therefore the selected research methodology guides the research and determines the research methods in collecting and analysing data.

Figure 3-1 Assumptions and research methodology



3.2.1 Ontology

Ontology refers to the theory of existence, which asks the fundamental question what exists. The answer to this question will determine what are accepted as "facts" and what can be known. A particular theory on what exists and the nature of being can be called ontology (Saunders et al, 2003). Ontology is the study of the relationships of the researcher with the thing being researched (Lacey, 1996). Key ontological questions concern: whether or not social reality exists independently of human conceptions and interpretations; whether there is a common, shared, social reality or just multiple context-specific realities; and whether or not social behavior is governed by "laws" that can be seen as immutable or generalisable (Ritchie and Lewis, 2003).

A realist ontology assumes that external world is made up of hard, tangible and immutable structures and that the world exists independently of one's perception of it. Materialism claims that there is a real world that consists of material independent of human beings (Kant, 1997). It has been argued that mainstream accountancy and modern science follow a realist ontology (Birkin, 2000).

By contrast, a subjective or nominalist ontology assumes that there is no "real" structure. Names and labels are used to negotiate a shared understanding of the external world. The world, therefore, does not exist independent of observation, but is a product of individual consciousness. The extreme nominalist position views reality merely as a projection of human imagination (Morgan and Smircich, 1980). Idealism asserts that reality is only knowable through the human mind and through socially constructed meaning (Ritchie and Lewis, 2003). Social constructivism assumes a nominalist position (Hines, 1988).

Morgan and Smircich (1980) identified six different ontological assumptions from objective to subjective point of view. Reality as a concrete structure; concrete process; contextual of information; realm of symbolic discourse; social construction; projection of human imagination. The transition from one perspective to another must be seen as a gradual one. It is often the case that the advocates of any given position may attempt to incorporate insights from others. These positions have been

continually debated but also modified so that they are understood in less extreme terms. However it does not mean that one position is better than another. As always, which is better depends on the research questions.

In this study, the selected phenomenon is relationship banking which is a concept in social science. Moreover, the researcher concerns with understanding actions not observed behaviours. Therefore the researcher believes that concepts from natural sciences are inappropriate for social sciences. Business and management research is often a mixture between positivistic and interpretive views, perhaps reflecting the stance of realism (Saunders et al, 2003).

In this research, it is assumed that reality is seen as a social construction (Morgan and Smircich, 1980). "The social world is a continuous process, created afresh in each encounter of everyday life as individuals impose themselves on their world to establish a realm of meaningful definition. They do so through the medium of language, labels, actions and routines, which constitute symbolic modes of being in the world. The social reality is embedded in the nature and use of these modes of symbolic action" (Morgan and Smircich, 1980 page 494). Corporations, banks and relationship managers construct a common social reality in the market for corporate banking. The interviewees are believed to have a common, shared understanding, which is accessible through those representations (Hammersley, 1992).

3.2.2 The Nature of Human Beings

Human nature is the characteristics, tendencies and behaviour of a human being. The assumption of human nature is one part of ontology that concerns how to treat the human beings (Saunders et al, 2003). This study investigates the actions of people and interactions among people. It is essential to make an assumption of human nature. In the literature there are some theoretical assumption of human nature. Douglas McGreagor developed a philosophical view of humankind with his Theory X and Theory Y book "The human side of enterprise" in 1960. These are two opposing perceptions about how people view human behaviour at work and organizational life.

Theory X assumes that:

- People have an inherent dislike for work and will avoid it whenever possible.
- People must be coerced, controlled, directed, or threatened with punishment in order to get them to achieve the organizational objectives.
- People prefer to be directed, do not want responsibility, and have little or no ambition.
- People seek security above all else.

Theory Y assumes that:

- Work is as natural as play and rest.
- People will exercise self-direction if they are committed to the objectives (they are NOT lazy).
- Commitment to objectives is a function of the rewards associated with their achievement.
- People learn to accept and seek responsibility.
- Creativity, ingenuity, and imagination are widely distributed among the population. People are capable of using these abilities to solve an organizational problem.
- People have potential.

McGregor (1960) sees these two theories as two separate attitudes and realizes that some of the theories he has put forward are unrealisable in practice. Moreover, recent studies have questioned the rigidity of the model. However, theory X and theory Y are still referred to commonly in the management and motivation literature.

Theory Z was developed by William Ouchi, in his book 1981 "Theory Z: How American management can meet the Japanese Challenge." Theory Z is often referred to as the "Japanese" management style, which is essentially what it is. Theory Z essentially advocates a combination of all that's best about theory Y and modern Japanese management, which places a large amount of freedom and trust with workers, and assumes that workers have a strong loyalty and interest in team-working and the organisation. Theory Z also places more reliance on the attitude and

responsibilities of the workers, whereas McGregor's X-Y theory is mainly focused on management and motivation from the manager's and organisation's perspective.

Jensen (1994) believes the innate imperfection of humans that people generally behave in self-interested ways. However, he argues that self-interest does not mean that people have no altruistic motives. People do care about failure and success, they do have emotions and care about honor and self-esteem, and they do feel shame and pride. Therefore incentive means motivate people. Jensen (1994) emphasize the explanatory power of REMM, the resourceful, evaluative, maximizing model of human behavior. "Whether they are politicians, managers, academics, professionals, philanthropists, or factory workers, individuals are resourceful, evaluative maximizers. They respond creatively to the opportunities the environment presents to them, and they work to loosen constraints that prevent them from doing what they wish to do. They care about not only money, but almost everything—respect, honor, power, love, and the welfare of others."

Morgan and Smircich (1980) outlined six assumptions about human nature in the subject-objective debate within social science including man as pure spirit, consciousness, being, man as social constructor, the symbol creator, man as an actor, the symbol user, man as an information processor, man as an adaptor, man as a responder.

This study recognizes both **human dignity and human opportunism**. The researcher believes that trust and authentic relationships can be established between the relationship managers represented the case banks and financial managers represented the corporate customers. Moreover, teamwork and inter-group cooperation can be achieved among people. The researcher believes that the human beings have an attempt to make work exciting and challenging. Therefore, directions, controls, rewards and penalties influence the human beings' effort in full potential. A set of actions/interactions are essential to accomplish the relationship strategy and improve the capability of relationship management. The increased interpersonal competence, inter-group cooperation, flexibility, and the like and should result in

increases in organisational effectiveness (Argyris, 1993). Hence, consequently, the intended outcomes may follow the actions/interactions.

In terms of the role of human nature, this study assumes that **man is a social constructor** (Morgan and Smircich, 1980). "Human beings create their realities in the most fundamental ways, in an attempt to make their world intelligible to themselves and to others. Individuals may work together to create a shared reality but that reality is still a subjective construction capable of disappearing the moment its members cease to sustain it as such. Reality appears as real to individuals because of human acts of conscious or unwitting collusion" (Morgan and Smircich, 1980 page 494). This study seeks to understand how this world is socially created by investigating the people involved in the social phenomenon.

3.2.3 Epistemology

Epistemology is the theory of knowledge. Epistemology is concerned with the nature, derivation, scope, and the reliability of knowledge (Lacey, 1996). It asks the fundamental question how can we know something or how do we know what we know. The answer to this question will determine what kind of logic that researchers will use to derive knowledge.

Positivism implies that knowledge can only be based on observation of what is. Positivism defines the world as objects and truth is to be found in agreement by verification (Parker and Roffey, 1997). However many qualitative researchers would not accept the positivist label as most would differentiate between the natural and the social world. Furthermore, most theologians would reject the positivistic concept of knowledge and the distinction between facts and values (Macquarrie and Childress, 1997). An anti-positivist epistemology rejects the objectivity and independence of the researcher and seeks understanding of the basis and source of "social reality". Anti-positivists tend to deny that science can produce objective knowledge (Burrell and Morgan, 1979).

Morgan and Smircich (1980) recognize six basic epistemological stances according to the different assumptions regarding ontology and human nature. From subjective to objective these epistemological stances include: to obtain phenomenological insight, revelation; to understand how social reality is created; to understand patterns of symbolic discourse; to map contexts; to study systems, process, change; to construct a positivist science. Tomkins and Groves (1983) discuss the six different epistemological positions for accounting research regarding the six ontological assumptions proposed by Morgan and Smircich (1980). Tomkins and Groves (1983) argued that valuable insights can be obtained from different perspectives and called for more qualitative research. Accounting researchers might, get closer to the practitioners' everyday world and focus on the practitioner's perspective and the meanings he puts upon events. In order to gain an understanding of the social reality, the main intention is to answer the question "what is going on here", to provide generalisable conclusions for wide segments of society. If individual definitions of situations and responses do prove to be widespread across locations and time, then general formal theories may be formulated (Glaser and Strauss, 1967).

An example of an epistemological position between positivism and anti-positivism would be the position adopted in grounded theory where truth is approximated by the researchers' creative engagement with a systematic, iterative data collection, analysis and validation process (Parker and Roffey, 1997). By contrast to an empiricist position, rationalists argue that the ideas originating from reason, which are intrinsic to the mind, are the primary source of knowledge. Rationalists would argue that it is possible through reason to obtain an "absolute description of the world uncontaminated by the experience of any observer" (Laughlin, 1995). Kant (1997) takes a middle view of these issues, stressing that both experience and reason can generate knowledge. Outhwaite (1983) argues that the entities, structures and mechanisms, which exist and operate in the world, could be discovered by a mixture of experimentation and theoretical reasoning.

In this study, reality is seen as a social construction and focuses on analyzing the specific processes through which reality is created. The researcher argues that reality resides in the process through which it is created and possible knowledge is confined

to an understanding of the process. Individuals make sense of their situation, create and sustain a semblance of reality. The aim of inquiry is to understand the methods relevant to the production of common-sense knowledge in different areas of everyday life. The task of epistemology is to demonstrate the methods used in everyday life to create subjectively an agreed or negotiated social order (Morgan and Smircich, 980).

Therefore, the epistemological stance of this dissertation is **to understand how social reality, which is relationship banking, is created** (Morgan and Smircich, 1980). "The epistemology that views reality as a social construction focuses on analysing the specific processes through which reality is created. Here, reality resides in the process through which it is created, and possible knowledge is confined to an understanding of that process" (Morgan and Smircich, 1980 page 497). This study adopts a position between positivism and anti-positivism (Parker and Roffey, 1997). The epistemological stance relevant to the empirical work is that **the knowledge can be obtained from both statistical and various qualitative methods.** In social sciences, a pure quantitative approach may be not always suitable, as some knowledge is based on the subjective experiences of people. Moreover, this study is particularly relevant in areas which are not well theorized. Therefore this study aims to get insights to a phenomenon by investigating the perceptions of participates.

3.2.4 Research questions

The choice of research methodology also depends on research questions and research objectives. This study answers an exploratory question and aims to develop a grounded theory and obtain a better understanding of relationship banking. Customer relationship in corporate banking is chosen as the broad research area in this study because the literature review indicated that there is scope for research in this area.

The research question selection process in this study can be described using the analogy of a funnel (Marshall and Rossman, 1995). The wide end of the funnel is where the general field of study is selected and as the researcher travels further into the funnel so different issues are considered. Some are rejected in the process, and on

arriving at the point at the end of the funnel the research question has become obvious.

Determining the questions is most significant for a topic and gaining some precision in formulating these questions requires much preparation. The purpose of a literature review is not only to determine the answers about what is known on a topic but also to develop sharper and more insightful questions about the topic. A literature review is a material part of the research process, taking a significant amount of the time and the energy to be expended on the research degree.

The literature review (Chapter 2) shows that the literature is fragmented and not comprehensively relative to the phenomenon. An in-depth study is necessary to explore this phenomenon to get insights into relationship banking. Furthermore, a grounded theory of relationship banking is needed to link and integrate relevant literature and obtain a better understanding.

In order to explore the phenomenon and get insight into relationship banking, it is important to get as close as possible to the place and interview the people involved in the phenomenon. The main research question for this dissertation is: **how does relationship banking create value from the perspective of relationship managers in corporate banking?**

The literature review recognizes problems and identifies research opportunities to meet these gaps. The interview questions are proposed and the answers are helpful to understand these problems. The literature review helps to indicate a suitable problem to research as well as gives the researcher some idea of the research methods or approaches that have been traditionally used in this field (Creswell, 1998).

This study explores the value creation process and gets insight into relationship banking. The objective of the dissertation is to identify categories and the relationship between theoretical elements identified in interviews.

3.2.5 Methodology

The combination of ontology, epistemology and research question defines methodology, which refers to a set of rules and procedures regarding how information is collected and how analysis is conducted (Hussey and Hussey, 1997). Two overall paradigms – the qualitative and the quantitative – have roots in 20th centaury philosophical thinking. The quantitative is termed the traditional, the positivist, the experimental, or the empiricist paradigm (Smith, 1983). The qualitative paradigm is termed the constructivist approach or naturalistic (Lincoln and Guba, 2000), or the interpretative approach (Smith, 1983).

The qualitative and quantitative paradigms have different assumptions based on ontological, epistemological, and methodological approaches (Lincoln and Guba, 2000). On the ontological issue of what is real, the quantitative researcher views reality as objective, independent of the researcher. For the qualitative researcher, reality tends to be seen as constructed by the individuals involved in the research situation. On the epistemological question, the quantitative approach holds that the researcher should remain distant and independent of that being researched. The qualitative stance is that researchers interact with those they study. For the axiological issue of the role of personal values in a study, the researcher's values are kept out of the way of the study in a quantitative project. This feat is accomplished through entirely omitting statements about values from a written report, using impersonal language, and reporting the facts closely from the evidence gathered in the study. The major difference between this approach and that of the qualitative researcher is that the qualitative investigator admits the value-laden nature of the study and actively reports his or her values and biases, as well as the value nature of information gathered from the field, the language of the study may be first person and personal. Another distinction is the rhetoric, or language of the research. When a quantitative researcher writes a study, the language should be not only impersonal and formal but also based on accepted words.

One approaches a quantitative methodology by using a deductive form of logic wherein theories and hypotheses are tested in a cause-effect order. Concepts,

variables, and hypotheses are chosen before the study begins and remain fixed through out the study. This approach has dominated the relationship banking literature reviewed in Chapter 2. Alternatively, in a qualitative methodology inductive logic prevails. Categories emerge from informants, rather than are identified a prior by the researcher. This emergence provides rich context-bound information leading to patterns or theories that help explain a phenomenon (Creswell, 1998). Holland (1994) conducts research using this approach in relationship banking.

A traditional role for qualitative research has been to help in devising areas of questioning for statistical study. This is particularly valuable in studies where the subject matter under investigation is new or underdeveloped and where qualitative methods can help to define terminology, concepts or subjects for investigation. Similarly, preliminary qualitative research can be of value when the subject matter is complex and where some identification of the underlying constructs is needed before relevant questions can be structured (Ritchie and Lewis, 2003). It is also of value when the existing literature displays contradictory result, and lacks a coherent conceptual framework or theory.

Another developmental use of qualitative research is to generate hypotheses for statistical testing. Because of its facility for in-depth investigation, qualitative research can point to possible connections between phenomena that might be difficult to detect through other means. Preliminary research can therefore help to identify the relevant variables for inclusion and indicate what kinds of association between them might be sought. Defining the dimensions of sample segmentation can be another output of preliminary qualitative research. Developmental research can help to designate the different groups or locations that exist among the study population and identify their defining characteristics. If these can then be captured in predefined questioning, statistical enquiry can measure the size of the sample segments and show how they distribute in relation to other variables (Ritchie and Lewis, 2003).

Based on a literature review, the problems in the literature were identified and the research questions were chosen for this study. This is an exploratory study investigating value creation in relationship banking. The objective of this study is to

get insights into the phenomenon and get a better understanding. This study aims to build theories from data to answer the research questions.

This study adopts a qualitative research to explore a complex phenomenon that is new and not well researched. **A qualitative research is suitable to identify concepts and connections among these categories by collecting and processing data through structured methods (Ritchie and Lewis, 2003).**

3.3 Grounded theory as a research methodology

Grounded theory has been utilised as an important research methodology in the investigation of complex phenomenon in the accounting and finance field. Straus and Corbin (1998) define grounded theory as "A qualitative research method that uses a systematic set of procedures to develop and inductively derive grounded theory about a phenomenon." Grounded theory offers a methodology, a way of thinking about and studying social reality (Strauss and Corbin, 1998). This study adopts a grounded theory approach to get insight into a complex and not well-researched phenomenon, relationship banking.

Methodology reflects the ontological and epistemological assumptions of the researcher (Llewellyn, 1992). Laughlin (1995) argues that it is essential for researchers to clarify their assumptions concerning the nature of knowledge, of reality and of human behavior. The grounded theory approach adopted in this dissertation has "middle range" methodological assumptions. This study can be located between the subjective and objective approaches in Morgan and Smircich's (1980) framework in terms of the assumptions on ontology, human nature and epistemology. This study seeks to understand the perceptions of relationship banking through the understandings of those involved in the practice. This grounded research is dependent upon both subjective sensibility of the researcher to the phenomenon researched and upon a research process.

Laughlin (1995) argues that choices concerning theory, methodology and change. More specifically they involve choices about the level of prior theoretization. High

theoretical levels refer to a world, which despite empirical variety has a high level of generality and order in theory and has been well researched. Low levels assume that the world is not material, is a projection of our mind, and generalities are impossible. In terms of Laughlin's (1995) schema the grounded theory approach adopted here has a medium level of prior theoretization, a medium level of theoretical nature of research methods, and a medium level of emphasis on 'critique of status quo and need for change. The grounded theory employed in this study seeks "skeletal generalizations". Laughlin's "change" dimension is concerned with the extent that researcher should lead to change in what is researched. In this study, the researcher could either promote change within the basic phenomena of relationship banking or just be used to maintain the status.

Grounded theory describes a methodological approach to the discovery and generation of theory directly from qualitative data (Glaser and Strauss, 1967). A grounded theory is inductively derived from the study of the phenomenon it represents. That is, it is discovered, developed and provisionally verified through systematic data collection and analysis of data pertaining to that phenomenon. Therefore, data collection, analysis and theory stand in reciprocal relationship with each other (Strauss and Corbin, 1998). In grounded theory, data collection and theory generation are considered as "two parts of the same process" (Glaser and Strauss 1967).

The grounded theory is a tool for qualitative investigation. The commonly referenced forms of data collection are social interaction, field studies, participant observation and interviews. This study employs interview as a main method to collect qualitative data. The researcher gets as close as possible to the phenomenon and interviews people who are involving in the phenomenon. The researcher can interview many different case banks and relationship managers to find out the variation in theoretical elements. Because of the problems of time constrain and accessibility interview may be better than other data collecting methods. In order to assure the creditability of primary data, secondary data such as annual reports, sectional analyses, published interviewees is colleted to complement the primary data and to cross-check information. Employing the concept of "triangulation", this study uses multiple

methods to collect data from multiple resources. The term "triangulation" has become an accepted practice to use some form of triangulation in social research (Blaikie, 1991). Data triangulation (Denzin, 1989) in this study involves using a number of different data sources and improves the ability of researcher to draw conclusions from the study (Scandura and Williams (2000).

The grounded theory focuses on the constant comparison of the data leading to coding and then categorization of the data. Constant comparison focuses on the simultaneous conceptualization and assessment of the similarities and differences in search of a core idea that could explain the overall phenomenon and the variability in relationship banking. Hypothesis formulation occurs before, during and after the process of data collection. The process of data collection, data analysis and hypothesis is interrelated and cyclical in that each may influence the other. Once the core ideal has been identified, new data is sought to confirm and disconfirm the elaborated concepts and the relationship among them (Wells, 1995). This process is continued until no new insights into these relationships in terms of the core idea or dimension are revealed. Theoretical saturation is achieved when no new information turns up in terms of refining the category or of its property, or of its relationship to other categories.

Definition of the theory is the final stage of the process. The resulting grounded theory is intended to be a rich, "powerful and parsimonious explanation" of the investigated phenomenon (Wells, 1995). As it is a form of inductive reasoning, once a theory has been arrived at, the process itself is complete and testing of the theory is not required to confirm its status as a validly grounded (Miller and Fredericks, 1999).

The grounded theory approach (Strauss and Corbin, 1998) adopted in this study allows use of prior theory and literature, concepts and ideas at the outset of fieldwork. The theories inform the research in multiple ways. "Literature can be used as an analytic tool if we are careful to think about it in theoretical terms." "It can furnish initial ideas to be used for theoretical sampling." "Initial interview questions or areas of observation might be based on concepts derived from literature or experience or, better still, from preliminary field work." "Some researches turn to the literature to

look for a unifying concept that might fit their data. They do this when they ... have an intuitive sense of what the central idea is but have no name for it." "This system helps analysts to locate their findings in the larger body of professional knowledge and to contribute to further development and refinement of existing concepts in their field." "However, the important point for the researcher to remember is that the literature can hinder creativity if it is allowed to stand between the research and the data" (Strauss and Corbin, 1998).

The literature in this study accomplishes several purposes. This study uses the literature to introduce the study and define the area of research, to generate and refine the research questions. The literature will help to develop a good understanding and insight into relevant previous research and the trends that have emerged. This enhances subject knowledge and theoretical sensitivity. This study utilizes literature to support the findings and compare with the findings. The study provides an actual evaluation of the strengths and critique of the weaknesses of the literature. The grounded theory approach can also help to integrate "bits" relative to a phenomenon from different literature.

In this qualitative research the literature is used in a manner consistent with the methodological assumptions. It is utilized inductively so that it informs but does not direct the questions asked by the researcher (Creswell, 1998). Moreover, It describes related literature in a separate section, and compares with findings. The dissertation also incorporates the related literature in the final section to compare and contrast with the result from the study (Locke, 2001).

3.4 Assessing the research method and methodology choices

The following paragraphs attempt to address the strengths and the limitations associated with the overall research design employed in this study, in an effort to provide some insights to the logic behind the methodological choices made here.

Every method may have advantages and disadvantages. Yin (2003) lists four criteria as requirements for good empirical social science research.

- Construct validity: Establishing correct operational measures for the concepts studied.
- Internal validity: Establishing causal relationships.
- External validity: establishing the domain to which the findings can be generalised.
- Reliability: Demonstrating that operations such as data collection and analysis could be repeated, and show the same result, in a similar case.

Yin's (2003) relatively objectivist criteria may reflect his greater concern with testing theory although he excludes internal validity as a criterion for exploratory studies. However, these criteria provide implications for assessing data, research process and research findings. For example, this study attempts to increase reliability, validity and credibility of data. The researcher asked broad questions and did not lead interviewees towards particular answers. In this study, multiple methods are employed to collect data from multiple resources. A number of in-depth interviews are implemented to improve the internal reliability and validity. A greater number of annual reports, sectional analyses, and published interviews are utilized by means of increasing external validity. External data also helps to check reliability of interview data. This study used evidence from three (triangulation) or more different sources (interview, observation, document analysis) to validate and crosscheck information (Patton, 1990). Multiple data resources including published observations are used in terms of reducing subjective bias.

This study mainly use grounded theory criteria to assess the research process and research findings. However, Yin's (2003) criteria are used in this study to assess the quality of data as grounded theory literature mentioned little about assessing data. Glaser and Strauss (1967) put forward criteria for judging the theory induced by their grounded theory approach. The theory must closely fit the substantive area in which it will be used. The categories must be readily applicable to and indicated by the data under study. The theory must be readily understandable to laymen concerned with this. A theory must be sufficiently general to be applicable to a multitude of diverse daily situations within the substantive area. The theory allows the user partial control over the structure and process of daily situations as they change through time. Locke

(2001) proposes "pragmatically useful" and "creditability" to evaluate the composed theory. He employs "pragmatically useful" to discuss Glaser and Strauss (1967) criteria, which Locke summarizes as fit, understandable, general, and control. A good theory is one that will be practically useful in the course of daily events, not only to social scientists, but also to laymen. In order to be practically useful, the theory and data must dovetail together. The theoretical framework must be understandable and sharpen people's sensitivities to the way in which they manage their work and the ways in which they might work differently. The theoretical framework is relevant to a number of different conditions and situations in the practice setting. Finally the theoretical framework must provide to the person using it a degree of control over the every day situations she is likely to encounter (Locke, 2001). In this study the composed theory is fed back to the interviewees to check the practical usefulness and appreciate their participation.

Locke (2001) discusses the credibility of grounded theory in terms of the practice, rhetorical issues, the relationship between the composed concepts and readers' experience, and researchers' own beliefs. "The credibility in term of research practice is achieved through theoretical sampling of comparison groups in order to extend the general applicability or analytic generalizability of the theory. The use of comparison groups simultaneously provides data for rich theoretical sampling and extends the range of conditions for which the theory is able to account." Generalization suggests the necessity of balancing theory abstraction and flexibility in application to ensure that the theory is "a general guide to multi-conditional, ever changing daily situations" (Glaser and Strauss 1967). This study collects a lot and a variety of data observations so as to allow for the comparing that creates rich and generalized conceptual categories. "The credibility is also a rhetorical achievement in terms of the quality of the composed theoretical elements and the writing practice of the author." The author's previous working experience and knowledge in corporate banking encourage the author's theoretical sensitivity in developing the theoretical categories and identifying the relationships among them. In order to help the readers to understand the theoretical framework this dissertation presents an abstract and a road map in the beginning of the manuscript in chapter 5, and then details the categories thereafter in chapter 6-8, and finally summaries the findings in chapter 9. The writing

practice of the grounded theory in this study will be discussed in detail in next chapter.

Finally, in order to achieve the credibility in terms of the researchers' own subjective experience, Glaser and Strauss (1967) suggest that the research need to have achieved a sense of conviction about theorizing. They point out that this conviction comes about not only because we have been present in the setting, and have systematically collected and analyzed data, but also because our emergent, we have in sense lived out our theorizing in our daily involving in the setting. They outlined the basic procedures through which researchers might compose theoretical elements and the research settings from which they derived. These include: giving meaning to individual and comparative data observations, pursuing meaning expressed in the data through a flexible data gathering method that punctuate the analytical process, and holding in abeyance existing theorizing on the topic of interest until the meaning is assigned to empirical observation. This study follows Strauss and Corbin's (1998) structure to process data. The procedure including open coding, axial coding and selective coding, will be discussed in detail in the next chapter.

3.5 Conclusion

In general, the methodological issues of this research were addressed in this chapter (Figure 3-2). The underlying philosophical and methodological roots of the study were thoroughly discussed. Ontology asks what is the nature of the reality we are exploring. As this research focuses on social phenomena, it is assumed that reality can be approximated as a contextual field of information where people are continually processing information, learning, and adapting to their environment (Morgan and Smircich, 1980). Another assumption in this study is that reality is seen as a social construction (Morgan and Smircich, 1980). Corporations, banks and relationship managers construct a common social reality in the market for corporate banking. In this study human beings are assumed to be trusting and have a strong loyalty and interest in team working (Ouchi, 1981). Trust, authentic relationship, and inter-group cooperation are able to develop among people. Because people generally behave in self-interested ways (Jensen, 1994), directions, controls, rewards and penalties

influence the human beings' effort in full potential. Human beings are treated as social constructors and information processors. Epistemology is the theory of knowledge (Lacey, 1996). The epistemological stance of this dissertation is both to understand how social reality, which is relationship banking, is created and to study the value creating process of relationship banking (Morgan and Smircich, 980). In this study the researcher believes that both quantitative and qualitative analysis can generate knowledge (Kant, 1997).

The main purpose of the study is to get insights into a not well-researched phenomenon. This study adopted a qualitative methodology -- an inductive logic aims to derive a theory from qualitative data (Creswell, 1994). A grounded theory approach (Strauss and Corbin, 1998) is a unique form of theory construction (Miller and Fredericks 1999). In the grounded theory investigation data is systematically collected and processed. This study employs semi-structured interview as a main method to collect qualitative data and secondary data is colleted to complement the primary data. Data triangulation in this study that uses multiple methods to collect data from multiple resources aimed to improve the reliability and validity of the results (Scandura and Williams (2000). The concept of theoretical sampling is pursued to extend the general applicability or analytic generalizability of the theory (Locke, 2001).

Figure 3-2 The methodological issues

Ontology	Human nature	Epistemology	Methodology
Reality is a social construction	Human dignity & opportunism Man is a social constructor	Understand social reality, study process Quantitative & qualitative analysis	Grounded theory A middle range thinking

However, there are some disadvantages that derive from these choices. This study investigates the relationship managers perceived value creation in relationship banking. A constraint is the problem of access. Moreover, it is hard to know if the

interviewees provide valid reflections and thoughts. For example, some interviewees may be lying or deceiving themselves or repeating marketing sentences. Sometimes misleading information may arise just because they lack of knowledge and understanding about their work. This study may involve the researcher's subjective bias by imposing his own views and concentrating on some interviews and ignoring the others. In terms of the generalizations that can be drawn from this research it is important to recognize that it is problematic to generalize beyond the case data.

Grounded theory study may be time consuming and cause high expenditure because the research involves field interviews and data processing. Moreover a major problem involves writing up and interpreting the research results, which is a long and laborious task. Finally, the experience and practice of researchers are essential in grounded theory research. Therefore it is a challenge for the novice to adopt this approach.

The next chapter will report the data collection and process of this study. It discusses the research methods by which the data was collected and processed in developing the theoretical framework. The next chapter introduces the procedure of grounded theory including open coding, axial coding and selective coding. It also discusses the writing methods employed in this grounded theory research.

Chapter 4 Research Methods

4.1 Introduction

The previous chapter discussed the research methodology adopted in this study. First, the ontological and epistemological positions in this study were addressed. Second, the assumption of human nature in this study was discussed. Third, the research question was introduced and the suitable methodology was chosen. Finally, the advantages and limitations of the selected methodology in this study were assessed.

This chapter discusses the research methods used in collecting data, processing data and writing up the grounded theory for this thesis. The data was systematically collected and processed according to the grounded theory approach selected in this study. Interview was employed as a main method to collect qualitative data and secondary data was colleted to complement the primary data and to cross check information. The grounded theory (Strauss and Corbin, 1998) approach consists of open coding, axial coding and selective coding in processing data and developing a theoretical framework. The chapter also discusses the writing methods employed in this grounded theory research.

4.2 Methods in collecting data

Llewellyn (1997) argues that methodology reflects the ontological and epistemological assumptions of the researcher whereas methods are secondary concerns around techniques used for data collection. In this study grounded theory is adopted also as a research method to collect data. According to Strauss and Corbin (1998), grounded theory requires that theory is derived from the data, which is systematically collected and processed. This section focuses on the data collection but this does not mean that data collection is separated. Data collection, analysis and theory formulation are regarded as reciprocally related. The initial data analysis is used to shape continuing data collection. This also provide the researcher with opportunities for increasing the "density" and "saturation" of identified categories and also for unexpected findings.

4.2.1 Theoretical sampling

In this grounded theory study, data collection is guided by theoretical sampling, or sampling on the basis of theoretically relevant constructs. Theoretical sampling is defined by Strauss and Corbin (1998) as: data gathering driven by concepts derived from the evolving theory and based on the concept of 'making comparisons,' whose purpose is to go to places, people, or events that will maximize opportunities to discover variations among concepts and to densify categories in terms of their properties and dimensions.

Building grounded theory requires an interactive process of data collection, coding, analysis, and planning what to study next. The researcher needs to be theoretically sensitive as they are collecting and coding data to sense where the data is taking them and what to do next. As this iterative process continues, the researcher may explore the same group more deeply or in different ways, or may seek out new groups. Comparison groups are selected based on their theoretical relevance to further the development of emerging categories perspectives (Glaser and Strauss, 1967).

Theoretical sampling is not statistical sampling. The number of cases is based on theoretical saturation. The appropriate number of cases is achieved when no additional data can be found that develops properties of the conceptual categories. Glaser and Strauss (1967) suggest that in order to reach saturation the researcher maximizes differences in his groups and the varieties of data bearing on the category, and thereby develops as many diverse properties of the category as possible.

In this study, the sampling was not planned in detail before the start of the field study. The researcher conducted 4 pilot studies during the beginning of the study. Pilot studies refer to mini versions of a full-scale study (also called 'feasibility' studies) done in preparation for the major study (Polit et al., 2001). Pilot studies were conducted to pre-test the importance of selected central phenomenon, the accessibility of case data, and the particular research instrument -- interview schedule (Baker, 1994). As categories emerge from the data, the sample was added to further increase diversity in order to strengthen the emerging theory by defining the properties of the categories. In order to make comparison this study investigates more banks in terms

of different size, location and management levels. The case sample also depends on the accessibility and other constrains such as language problems.

Sampling ends when all the categories are saturated in collecting and interpreting data about a particular category. Theoretical saturation means a category has been saturated with data. This means no new or relevant data seem to be emerging regarding a category, the category is well developed in terms of its properties and dimensions demonstrating variation and the relationships among categories are well established (Strauss and Corbin, 1998). There was a point of diminishing returns and eventually the interviews add nothing to a category, its properties, and its relationship to the core category. This study was very careful to confirm that the theoretical saturation achieved. In same cases ten or less interviews was sufficient for building a grounded theory. At the end of the data collection, in this study twenty-two interviews were conducted with different levels corporate banking directors in fifteen different case banks in terms of locations and sizes. Table 4-1 illustrates the interviews conducted in this study. Every interview was given different codes in the first column. The quotes employed in the later chapters were referred to this table.

Table 4-1 Interviews

Code	Name	Bank Type	Position of interviewees	Place	Time D/M/Y
ULAD	Bank A	UK based large	Director of commercial banking	Manchester	13:30, 18/06/2004
UMBR	Bank Ba	UK based multinational	Relationship manager	Glasgow	10:00, 20/11/2003
UMBD	Bank Ba	UK based multinational	Director of corporate banking	London	9:30, 07/05/2004
ULBD	Bank Br	UK based large	Director of business banking	Glasgow	11: 30, 06/03/2004
CMCR	Bank Cb	China Based multinational	Relationship manager	Glasgow	20:00, 02/112003
SMCD	Bank Ch	US based multinational	CEO of corporate banking	Shanghai	10:30, 25/03/2004
SMCC	Bank Ci	US based multinational	Director of corporate banking	Shanghai	11:00, 24/03/2004

UMHD	Bank H	UK based multinational	Director of corporate banking	Glasgow	10:00, 05/12/2003
UMHR	Bank H	UK based multinational	Relationship manager	Shanghai	10:00, 26/03/2004
IMIH	Bank I	Ireland based Multinational	Head of marketing & strategy	Glasgow	11:30, 18/06/2004
ULKR	Bank K	UK based large	Relationship manager	Glasgow	10:30, 26/07/2002
ULKD	Bank K	UK based large	Director of corporate banking	Glasgow	10:30, 26/07/2002
ULKC	Bank K	UK based large	Chief executive officer	Glasgow	11:00, 08/06/2004
UMLS	Bank L	UK base multinational	Senior relationship manager	Glasgow	10:00, 27/11/2003
ILNG	Bank No	Ireland based large	General manager	Belfast	15:30, 28/06/2004
UMND	Bank Nt	UK based multinational	Director of commercial banking	Glasgow	15:00, 06/05/2004
ULND	Bank Nw	UK based large	Divisional director commercial	Glasgow	11:00, 23/06/2004
UMRD1	Bank R	UK based multinational	Director of corporate banking 1	Glasgow	10:30, 11/04/2003
UMRD2	Bank R	UK based multinational	Director of corporate banking 2	Edinburgh	10:30, 26/02/2004
UMRR	Bank R	UK based multinational	Relationship manager	Glasgow	15:30, 08/09/2004
UMSD1	Bank S	UK based multinational	Director of corporate banking 1	Edinburgh	10:00, 20/02/2004
UMSD2	Bank S	UK based multinational	Director of corporate banking 2	Glasgow	10:00, 24/07/2002
UMSR	Bank S	UK based multinational	Relationship manager	Edinburgh	14:00, 23/02/2004

The initial sample is likely to be defined by the choice of research situation. This is because of the convenience and feasibility. The researcher interviewed the director of corporate banking in four Glasgow local banks in 2002 and 2003 (Table 4-1). This

helped the researcher to understand the feasibility of the research question and the accessibility of the case data. The sampling during the beginning of the study was rather unfocussed, it become more focused as the study progresses.

In this research, during the initial open coding stage, theoretical sampling was done as wide as possible to enable researchers to be open to discover concepts in the situation. Besides the initial four case interviews, seven interviews were conducted in year 2003 and 2004, with purposive and systematic procedures, to discover and identify data which is relevant to the research question. These case banks were located in diferent places and different in sizes. During axial coding, sampling is done to define the dimensions and properties of the categories as well as to define the sub-categories and their relationships to the categories. Six interviews were conducted in early 2004 with corporate banking directors in different levels in the case banks. The case data was collected to confirm, elaborate and validate the relationships between categories. During selective coding, sampling is used to strengthen the theory. Five more interviews were conducted in 2004, with deliberate and directed selection of individuals, sites to confirm and verify the core categories and the paradigm model.

4.2.2 Interviews

Case interviews were employed in this study as the main source of primary data. The use of case data has increased dramatically in recent years, especially in accounting and management research. Interview is a good way to go to the place and talk with the actors to collect case data. This allows the researcher get as close as possible to the people involved in the phenomenon. Case data can be used in developing grounded theory (Parker and Roffey, 1997).

This research method was adopted in this study because the researcher was trying to delve into corporate banking directors real worlds, and to investigate their beliefs, actions and perceptions. Five broad interview questions[14] were asked and therefore the interviewees could freely talk for one hour. The interviews focused on the verbalized thoughts of the relationship managers based on their understanding of their daily action. This emphasized the importance of the experiences of interviewees. In

[14] Five interview questions were introduced in Chapter 1, and discussed throughout the literature review.

the study, the case interview data was used as the basis for developing a grounded theory to understand the phenomenon, which was relationship banking, from the perception of corporate banking directors. Moreover, the case data was used to provide short cases and quotes to enliven and illustrate the concepts and categories identified.

Each participant was contacted and received the broad interview questions before the interview and they were well prepared to explain their own views in considerable detail. One of the letters sent to the interviewees was appended in Appendix 1. The interview questions were designed to allow the participants to interpret and describe the phenomena in their own way. The research questions were formed after the literature review and confirmed after the pilot studies. An attempt was made to ensure that the participants were not focused down on precise questions. The only focus was the broad area of relationship banking. The interview questions were designed to investigate the interviewees' perceptions on why the phenomenon emerged and what they do around this phenomenon and how they think about this phenomenon. There were some detailed questions reserved to remind the interviewer if some questions had not covered by the participants. The researcher timed the interviews and made sure that every question was allocated with balanced time. There was a sight seeing around the working places and description about the scenes after the interviews.

At the start of the interview the participants were asked to talk freely about the broad questions and to discuss them from their own experiences. The interviewees not only explain what is going on, but also tell the researcher how they view the situation. The researcher's main roles were to record the subjective views of the interviewees and to empathies with interviewees so that a trusting, open atmosphere prevailed. Their commentary was not disrupted during the interviews. The researcher asked some specific questions if a major aspect of the research questions had been omitted. The interviews went very well as the participants were friendly and responsive. There was a high success rate achieved in securing interview access. They also provided considerable breadth of coverage in their views on the research questions.

The researcher took notes during the interviews and developed them to themes afterwards. Moreover, exploratory ideas were noted at this point and added to a

theoretical memo file later. This file captured the learning by the researcher during the data collection process. The interviews were tape-recorded and transcribed word-by-word. This was time consuming but the full transcripts were essential in data processing. Strauss and Corbin (1998) suggest that writing a theoretical memo continues in parallel with interview data collection, note-taking and coding. A memo is a note about an emerged hypothesis, a category or property, and particularly about relationships between categories. Glaser and Strauss (1967) emphasize the high priority of writing a memo whenever an idea occurs. Memos help to remember particular analyses and focus future data collection and coding to explore ideas in the memos. When a large number of memos have accumulated a theoretical memo might be developed. A theoretical memo considers possible theories that the data may support (Strauss and Corbin, 1998).

4.2.3 Secondary data

The grounded approach advocates the use of multiple data sources converging on the same phenomenon and terms these "slices of data" (Glaser and Strauss, 1967). In grounded theory, neither one kind of data on a category nor technique for data collection is necessarily appropriate. Whatever the source, whether interview, observations, documents, in whatever combination, data is always as good as far as it goes. These data are used for conceptualization, not for accurate description. Different kinds of data give the analyst different views to understand a category and to develop its properties. There is always more data to keep correcting the categories with more relevant properties (Glaser, 2001). Different types of data can be observed in various ways in a grounded theory approach. Therefore, this study used interviews to collect primary data and other techniques to gather secondary data.

The principal archival data source in this study was material in the form of annual reports, published interviews and presentations, sectional analysis on the case banks' web sites. These data were extracted in computerised form and collected from public and semi public domain sources such as e-journals, online newspapers, and website news releases. Attendance at practitioner events or conferences was a useful way of collecting material not normally available in the public domain. The researcher attended the International CRM Forum 2004 in Shanghai to collect some useful

information. For example, a speaker who represented a best practice award bank gave an interesting presentation to share their understanding and experience in relationship banking. It was also a good opportunity to visit the case banks and communicate with the practitioners. In this study the documentary sources were treated like sets of field notes. These data provided alternative sources of confirmation or contradiction of interview data. Three years annual reports and other materials were put together with the interview transcripts. An example of the case data is enclosed in Appendix 2 to show how these data were organised in this study.

In this study literature was seen as data and the literature review was one of the methods to collect data. Glaser (2001) argues that it makes sense to access relevant literature as it becomes relevant. He suggests reaching a wider sample, in effect, by refining the findings in the light of the literature in slightly different but related fields. A progressive accessing and reading of relevant literature can become a part of data collection procedures. Constant comparison with the emerging theory remains a core process in this study. When there is an apparent disagreement between the emerging theory and the literature, it does not mean that the emerging theory is wrong. The comparison is aimed to extend the theory if it fits both the data from this study and the data from the literature.

4.3 Methods in processing data

Data analysis is central to grounded theory building research. The basic idea of the grounded theory approach is to read a textual database and discover or label variables, which are called categories, concepts and properties, and their inter-relationships. The ability to perceive variables and relationships is termed "theoretical sensitivity" and is affected by a number of things including one's reading of the literature and one's use of techniques designed to enhance sensitivity. In this study the researcher took considerable care with the use of extant literature to sensitize the researcher during data collection and analysis.

Strauss and Corbin (1998) emphasize the systematic nature of the grounded theory method in processing data. The theory arises from the data by employing systematic methods of analysis. A theory is defined by Strauss and Corbin (1998) as "a set of

well-developed categories (e.g. themes, concepts) that are systematically interrelated through statements of relationship to form a theoretical framework that explains some relevant social, psychological, educational, nursing or other phenomenon." The systematic data analysis involved generating concepts through the process of coding, which is the central process by which theories are built from data. Coding is defined as the analytic process through which data are fractured, conceptualized, and integrated to form theory (Strauss and Corbin, 1998). Strauss and Corbin identify three different types of coding to develop a grounded theory: open coding, axial coding and selective coding. In this study the researcher analyzed data in line with these methods. However, it does not mean that the researcher followed from open through axial to selective coding in a strict, consecutive manner. The different types of coding were doing simultaneously and the division between them was an artificial way of explaining the process.

In this study an important activity during coding is the writing of memos. Memos are not simply "ideas." They are involved in the formulation and revision of theory during the research process. The memos were used to record the researchers own thoughts as they arose during data collection. Moreover, the memos were also utilized during data processing. The use of memos helped the research to keep track of all the categories, properties, hypotheses, and generative questions that evolve from the analytical process (Strauss and Corbin, 1998). The researcher produced memos for each case data. Appendix 3 contains an example of memos a case bank data. Appendix 4 shows the theoretical memo cumulated all memos for all of the case data.

4.3.1 Open Coding

Open Coding is the analytic process through which concepts are identified and their properties and dimensions are discovered in data (Strauss and Corbin, 1998). To be able to identify the concepts the researcher has to open up the text and expose the thoughts, ideas, and meanings contained therein. In this study open coding involved reading and rereading of the case interview data to line-by-line and paragraph-by-paragraph to understand an event, action and opinion. Open coding was a part of the analysis concerned with identifying, naming, categorizing and describing phenomena found in the text. In this study, each line, sentence, paragraph was read in search of

the answer to the repeated question "what is this about? What is being referenced here?"

Data in this study were compared and similar incidents were grouped together and given the same conceptual label. A concept was seen as an abstract representation of an event, object, or action/interaction that a researcher identifies as being significant in the data. For example, the following shows how the researcher understands the sentences (the words or sentence inside the parentheses) and identify and name the concepts (bold letters).

> "Q: Why do you establish long-term relationships with corporate customers?
>
> A: We establish long-term relationship with our customers. There are some reasons behind this. By establishing close relationship we may know customers well and understanding their business (Understand customer business, and therefore **Customer knowledge**), and can see what we can do for their business (Identify needs, and therefore **business opportunity**). We have opportunities to promote (**Up selling**) and meet customers' needs (**Customer needs**) going forward (Maintain customer relationship), which will result in additional products sell (**Cross-selling**) and hereto incomes from the connections (**Income**). Presumably, banking is very similar things (the nature of banking industry). Customers can choose any banks to do business. Why they choose us because they know us and we have relationships and they know we may help them (**Customer confidence**). Otherwise they will go somewhere else. We are requiring new customers (**customer acquisition**). Actually we still look at your existing customers (**Customer retention**). It is far more cost effective than massive campaign in terms of requiring new customers (**cost effective**). It enables us to understand the customer: how more closely understand their credit reference (**Credit rate**), understand their trading record (**Credit history**), then we will do important decision on

> lending products (**Decision making**) because you build trust (the nature of bank-corporate relationship, **trust based relationship**) over a number of years (why long-term relationship, the nature of corporate banking)." ULAD

Once opened up text and got some concepts, the researcher realized that certain concepts could be grouped under a more abstract concept. For example, the interviewees perceived that their corporate customers could get benefits from relationship banking.

> "Every company will have a bad time (**Financial difficulties**). If things go wrong, we will help them when they get into trouble (**Bank help**)." ULND

> "Relationship banking means we should support them (**Bank help**) through difficult time (**Financial difficulties**), not just make money at anytime (**Maintain customer relationship**)" UMRD1

> "If suddenly the profit goes down (**Temporary difficulties**), we need to come to see you. We can sort it out perhaps to help them (**Bank help**)." UMLS

These sentences mean that the corporate customers are able to get in-time help from the case banks when they have temporary financial difficulties. This concept was seen as a benefit of relationship banking for customers and named as **"in-time help"**.

The process of grouping concepts at a higher, more abstract, level is termed categorising. Categories emerge from similar concepts that have similar properties. Properties are characteristics that are common to all the concepts in the category. For example, in this study, about the measurement of bank-corporate relationship one might ask about its duration, and its closeness, and its importance to each party. The categorization of concepts into categories is an abstraction process. For instance, the following quote shows how the researcher develops a category.

> "The environment in banking industry is more and more competitive (Outside condition or **Macro condition**). We establish close relationships because we want to make important decisions on lending products (**Credit risk**). We have opportunities to meet customers' needs (**Up-selling**) and sell additional products (**Cross-selling**) and therefore more incomes from the connections. It is far more cost effective to keep customers than requiring new customers (**Cost effective**)." ULAD

The interviewees explain why they choose relationship banking and identify many reasons. These factors are put together into a category as "**Causal conditions**".

The researcher can give names for concepts and categories. The names can also come from the words of the respondents. It should however be a logical descriptor of what is going on (Strauss and Corbin, 1998). The categories should be grounded in reality. Literature may be used to add new categories, but such categories must be verified by the data, which means also be grounded in reality. The interpretation of events by the researcher influences the naming of categories (Strauss and Corbin, 1998). Dimensions represent the location of a property along a continuum or range. Categories gave us a method for comparing different incidents. Incidents were compared in terms of properties and dimensions. Categories can be defined into subcategories that answer questions like what, when, where, who, how, and with what consequences about categories. The relationships between categories were studied to form theories.

4.3.2 Axial Coding

Whereas open coding fractures the data into concepts and categories, axial coding puts those data back together in new ways by making connections between a category and its sub-categories. Axial coding is defined as the process of relating categories to their subcategories, termed "axial" because coding occurs around the axis of a category, linking categories at the level of properties and dimensions. The purpose of

axial coding is to reassemble data that were fractured during open coding (Strauss and Corbin 1998). Axial coding refines information about each category or subcategories.

Although axial coding is different in term of purpose from open coding, these are not necessarily sequential analytic steps; no more than labeling is distinct from open coding (Strauss and Corbin, 1998). Axial coding looks at how categories crosscut and link. In axial coding, the analyst is relating categories at a dimensional level. In this study the case data were read again and again for these larger conceptual categories. This was the means to collect several micro concepts together and identify a larger conceptual category. Eventually it was possible to condense the micro concepts into larger macro concepts. In reading the case data, it was necessary to keep the question in mind. What is the central core or macro concept that covers the variation in micro concepts? The micro data were combined around the axes of an aggregate core code or macro concept. The case data were read to see how the micro concepts were used in different context. This was the means to collect several micro concepts together and identify a larger conceptual category. For example, all of the interviewees emphasized that relationship banking was very much about knowing customers. Did knowing customer mean different things in different case banks and contexts and was it repeated in the same way across cases? How was a more general aggregate form of these concepts used across the cases? Eventually it was possible to condense the macro concepts into larger macro concepts.

Open coding: many micro concepts occurred in the case banks, concerning knowing customer.

Knowing Customer

Past......................................Current......................................Future

Customer History Customer Product Customer Sale Customer Profit Customer Plan

Axial coding: Asking what is the central core or macro concept that covers this variation in open code concepts? Recombine the open code around the axes of an aggregate core code – **"Customer information and knowledge"**.

Thus in the case banks, many dimensions of customer information and knowledge were eventually crystallized into a larger conceptual category called **"Exchange of**

information and knowledge". All of the above micro concepts were identified as part of larger concept of "**Information and knowledge management**". This concept recurred across all of the cases, but manifest itself in each case.

Axial coding is the process of relating open codes (categories and properties) to each other. To simplify this process, rather than to look for any and all kind of relations, this study emphasizes causal relationships, and fit things into a basic frame of generic relationships. The conditions, actions/ interactions, and consequences associated with the central phenomenon were identified to describe the context and the process of a phenomenon. Since a category is a coded form of a phenomenon, it can be seen as a representation of a pattern of happenings, events, or actions/interactions, which can be described by conditions, actions/interactions and consequences. In this study, conditions explain the situation or context in which a phenomenon occurs. Conditions can be causal, intervening and contextual. Contextual conditions are the specific sets of conditions (causal and intervening) that intersect dimensionally at this time and place to create the set of circumstances or problems to which persons respond through actions/interactions. In this study, actions/interactions were the answers to the question of how people handle the conditions. Strategic actions were actions that were purposeful in solving a problem and thereby shaped the phenomenon. Ongoing actions represent every day responses to situations. Both these types of actions need to be investigated to gain full understanding of how people maintain the social order (Strauss and Corbin, 1998). Irrespective of whether action is taken in response to a problem situation or not, there are always consequences. Some of these consequences are intended and others not. This study more concentrated on intended consequences or benefits. The consequences and their changing of the phenomenon were described in order to understand a phenomenon completely. Consequences have properties such as duration, visibility, impact, predictability and scope.

For example, in this study, the categories including Relationship Orientation, Customer-centric Organisation, Customer Value Based Performance Measurement and Incentive-Based Compensation were integrated into Strategic Actions/Interactions. Moreover, Trust-based Personal Communications, Internal Cooperation, Exchange of Information and Relationship Transactions are integrated

into Ongoing Actions/Interaction. Both Strategic Actions/Interactions and Ongoing Action/Interactions were integrated into a macro category, Actions/Interactions, to explain how the case banks conducted relationship banking.

Axial coding is about finding relationships between categories and subcategories. These relationships were validated against the data from the actual incidents to determine if they can be grounded in reality. Contradictions between reality and the hypothesis help the researcher to refine the description of the category by refining the conditions, actions/interactions and consequences of phenomena.

4.3.3 Selective Coding

Selective coding is the process of integrating and refining the theory (Strauss and Corbin, 1998). Open coding concerns with generating categories and their properties and dimensions. In axial coding, categories are systematically developed and linked with subcategories. Categories are only descriptions of data and are not yet a theory. The major categories need to be integrated to form a larger theoretical scheme that the research findings take the form of theory. The research findings should be presented as a set of interrelated concepts, not just a listing of themes. The first step in integration is deciding on a central category. In this study, selective coding involved the integration of the categories that have been developed to form the initial theoretical framework. After a time one category will be found to emerge with high frequency of mention, and to be connected to many of the other categories which are emerging. This is the core category that represents the main theme of the research. Strauss and Corbin (1998) give the following criteria for choosing a central category:

- It must be central; that is, all other major categories can be related to it.
- It must appear frequently in the data. This means that within all or almost all cases, there are indicators pointing to that concept.
- The explanation that evolves by relating the categories is logical and consistent. There is no forcing of data into a grounded theory.
- The name or phrase used to describe the central category should be sufficiently abstract that it can be used to do research in other substantive areas, leading to the development of a more general theory.

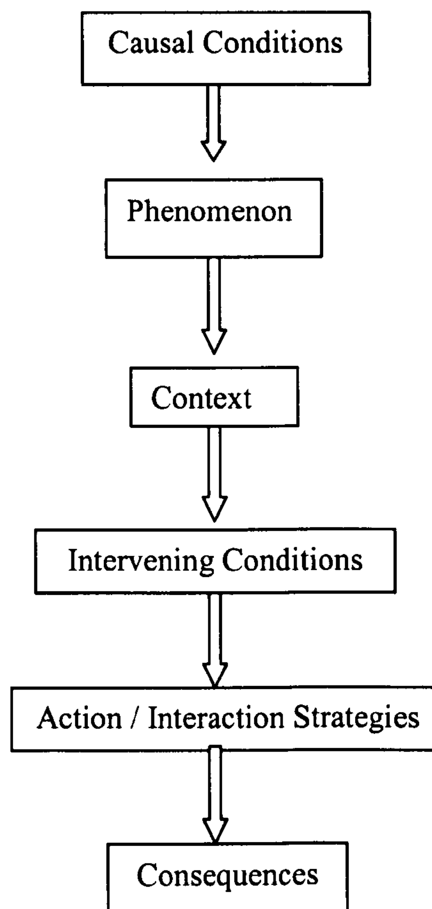
- As the concept is refined analytically through the integration with other concepts, the theory grows in depth and explanatory power.
- The concept is able to explain variation as well as the main point made by the data; that is, when conditions vary, the explanations still holds, although the way in which a phenomenon is expressed might look somewhat different. One also should be able to explain contradictory or alternative cases in terms of that central idea.

The core category (the central idea, event or happening) is defined as the central phenomenon. Other categories are then related to this core category according to the schema. "The core category must be the sun, standing in orderly systematic relationships to its planets" (Strauss and Corbin, 1998). In this study relationship banking was selected as the central phenomenon. The axial codes surrounding the central activity were based on causal conditions, influences, context, intervening conditions, actions, interaction strategies, and outcomes. In this way a theoretical structure of connected concepts was constructed with the focal core code at its heart, linked to the other core or axial (major concepts) codes. Parker and Roffey (1997) point out that the central activity or phenomenon was placed at the centre of a flowchart diagram. In this study subsidiary categories were related to the core category according to the paradigm model (Figure 4-1), the basic purpose of which was to enable the researcher to think systematically about data and relate them in complex ways. This paradigm relates structure with process. The structure or conditions set the stage and create the circumstances in which a phenomenon is situated. Process denotes the action/interaction over time in response to certain issues. Combining structure with process helps analysts to get a comprehensive picture. Process and structure are inextricably linked and therefore in order to understand the phenomenon one must understand the nature of their relationship. By studying structure one learns why and by studying process one understands how persons act/interact. By studying both structure and process one can capture the dynamic and evolving nature of events.

The basic idea was to propose linkages and look to the data for validation (move between asking questions, generating propositions and making comparisons). Causal

conditions are the events that lead to the development of the phenomenon. Context refers to the particular set of conditions and intervening conditions, the broader set of conditions, in which the phenomenon is couched. Action/interaction strategies refer to the actions and responses that occur as the result of the phenomenon and finally, the outcomes, both intended and unintended, of these actions and responses are referred to as consequences. The paradigm model of this study is presented in Chapter 5.

Figure 4-1: The Paradigm Model



Source: Pandit (1996) The creation of theory: a recent application of the grounded theory method

There are several techniques to determine the central category. These include writing the storyline, making use of diagrams, and reviewing and sorting memos either by hand or by computer program. A story is simply a descriptive narrative about the central phenomenon of study and the story line is the conceptualisation of this story

(abstracting). When analysed, the story line became the core category. Appendix 5 shows the storyline of this study.

The final theory and report is typically the integration of several theoretical memos. In this study, when the central category was described, by writing a storyline the gaps in the theory were exposed. Refining the coding of major categories should fill these gaps. The aim was to write a story to which incidents in the data can be fitted. The story only became a grounded theory when data representing incidents in reality were fitted to the story. Cases that do not fit the storyline were explained in terms of intervening conditions. Discovering outlying cases and building explanations into the theory for them increases its generalisability and explanatory power.

In order to validate the theoretical scheme, the researcher went back and compared the scheme against the raw data. It is important to make sure that the theoretical scheme fits with the raw data and can explain most of the cases. Moreover, the findings were sent back to the interviewees to get comment on how well it seems to fit their cases. The story might not fit every aspect of each case but the interviewees perceived it as a reasonable explanation of what was going on.

4.4 Methods in writing up the findings

In order to ensure that the researcher has developed a credible theoretical scheme in terms of the validity and plausibility, it is important to write manuscripts that richly illustrate the theory. The written work must demonstrate the groundedness of the theoretical elements and good practice of the analytic operations performed. Moreover, the written work needs to achieve authenticity and a solid data theory coupling (Locke, 2001).

To develop authenticity, readers need to be convinced that the researcher understood the phenomenon from the actors' point of view. To achieve the solid data theory coupling, the presentation of grounded theory must take the readers analytically forward to the developed theoretical elements and back to the data fragments that instanced the theory. The written work needs to weave together data incidents and theoretical elements. The data incidents demonstrate that the researcher authentically were present to and captured the realities of those they studied, while the theoretical

points underscore that researchers understood the general significance of those particular incidents (Locke, 2001).

It is important to integrate relevant existing literature into the presentations of data indicated theoretical elements. Locke (2001) suggests how to use the literature in the presentation of grounded theory. Writing the literature in grounded theory is sometimes integrated into the presentation of the model in what is usually the findings section of the manuscript. Furthermore, the relationship between their grounded theory frame and a broader literature to which it makes a contribution is sometimes a problematic issue, because the research questions are not usually framed in terms of existing theory (Locke, 2001). The literature is employed in this study in three senses. First the literature is used to establish the phenomenon and problem area to be investigated. Second, each major results section contains a succinct summary of the case results within key grounded theory themes or elements and these are both discussed within relevant literature. Finally, the overall model is discussed within relevant literature in the conclusion section.

Locke (2001) emphasizes that the written work need to accomplish three things: to heighten understanding of the approach used and its potential for developing knowledge, to convince readers that the researchers followed procedures associated with good scientific practice and to increase the transparency of the actual procedures followed. First, the nature of the approach needs to be informed. Grounded theory is an inductive, theory building methodology that allowed the researcher to develop a theoretical account of the general feature of a topic while simultaneously grounding the account in empirical observation or data. Second, the particular usefulness of a grounded theory approach needs to be claimed. For instance, the analysis of transcripts involved the identification of common themes. Third, in order to increase transparency of procedures it is necessary to describe how the data documents were approached to derive conceptual categories. Appendix 3 shows the memo containing concepts and categories derived from one case data.

Locke (2001) argues that the presentation of grounded theories similarly follows a format that involves the telling of theoretical elements and the showing of data fragments that instance them. This format can be outlined to summarize the

theoretical frame – serially present each theoretical element well illustrated with data instances – summarized the theoretical frame. In this study, the grounded theory of relationship banking is presented as a "paradigm model" recommended by Strauss and Corbin (1998). This is a conceptual analytical device for organizing data and for integrating structure with process and for summarizing the grounded theory of relationship banking. The paradigm model reveals how the grounded theory elements are connected and thus provide a "map" to steer through the ensuring detailed results. It should however be noted that the paradigm model is an aggregate result of these detailed results. This abstract of the findings is presented in the next chapter. The individual categories are presented in detail thereafter in three chapters. Finally, the summary of theory is presented in the conclusion chapter. Case quotes are used throughout these sections to illustrate these elements through interviewees' voices and thus the theory is grounded explicitly in the case data.

The individual categories are presented employing Locke's (2001) format. For example, Chapter 6 presents the causal conditions of relationship banking. The content was accomplished as follow: An excerpt foreshadows the key points of the reasons of adopting a relationship-banking strategy. Then the chapter summarizes the theoretical framework of why the case banks chose relationship banking as their business strategy. The detailed presentation of each theoretical element is followed. The theoretical elements are arranged as headings under which the telling of story and showing of data are integrated. Meanwhile the relevant literature is integrated into the findings. In addition, figures are utilized to illustrate the relationship among categories and subcategories.

4.5 The weaknesses of grounded theory methods

Grounded theory research has been criticized by some scholars. This section discusses some problems of grounded theory and how this study responds to these criticisms and reduces these weaknesses.

Similar to other qualitative approaches grounded theory research has been criticized as being too subjective (Bryman, 2004). There are several possible components of

this criticism. First, the research topics that qualitative researchers choose depend on what strikes them as significant. Second, the responses of participants are likely to be affected by the characteristics of the researcher. Third, because of the nature of qualitative data, interpretation will be profoundly influenced by the subjective leanings of a researcher. Because of these subjective problems, the developed grounded theory may have some problems. For example, the distinction between micro and macro is an artificial one. Conditionals and consequences usually exist in clusters and can associate or co-vary in many different ways, both to each other and to the related actions/interactions. Furthermore, with time and the advent of contingencies, the clusters of conditions and consequences can either change or rearrange themselves, so that the nature of relationships or associations that exists between them and the actions /interactions also changes. Moreover, because of these factors grounded theory research is criticized in terms of lack of credibility and replicatability.

In this study the researcher argues that this grounded theory research does not avoid subjectivity. Social phenomena need to be understood and interpreted by people. Human intelligence especially theoretical sensitivity is essential in grounded theory study. However, in the process of interpretation and theorizing the researcher may fail to do justice to what they have seen and heard that they may contaminate their subjects' words and behaviors. This is a risk, but it has to be balanced against the fact that the findings acquire significance in the intellectual community only when the researcher has reflected on, interpreted and theorized the data. In order to improve the creditability the researcher takes following actions. First, this study keeps a record on collecting and processing data. Some examples of case data and theory development are attaching in the appendices. The original materials are well kept to be traced back to the raw data. Second, the researcher intended to decrease subjective bias in collecting and processing data. This study interviews several relationship managers in the same case banks and collects secondary data for cross checking information. The researcher focuses on data and make sure that the theoretical themes are grounded on data and not based on own opinions. This study shows many data quotes to support the derived themes and therefore addresses the subjectivity to some extent.

Bryman (2004) argues that it is almost impossible to conduct a true replication of qualitative research, since there are hardly any standard procedures to be followed. However, Strauss and Corbin's (1998) grounded theory procedures are strictly followed in this study because this approach is well developed and structured. The data collection is guided by theoretical sampling. Different case banks in terms of size, location, and style are contacted and different levels of relationship managers are interviewed. Some relationship managers in the same case bank are interviewed to cross check and compare the information. This study investigates the best and bad practice case banks in relationship management judged by professional organizations such as CRMguru and GreaterChinaCRM. This study also looks for negative cases to discover variations among concepts and to density categories in terms of their properties and dimensions (Strauss and Corbin, 1998). The researcher asks broad questions and does not interrupt or lead the conversations. This study strictly employs Strauss and Corbin's (1998) grounded theory approach to process data. Open coding, axial coding and selective coding procedures are utilized to develop the grounded theory. Locke's (2001) methods are used in presenting the theoretical framework and grounded theory elements.

Moreover, the grounded theory approach is criticized as lack of transparency. It is sometimes difficult to know from a grounded theory report what the researcher actually did and how he or she arrived at the study's conclusions. For example, sometimes it is unclear about how people are chosen for observation or interview, and how the researcher knows the study should finish. Moreover, it is often not obvious how the analysis is conducted and how the study's conclusion are arrived at. In this study, the researcher addresses the data collection and analysis process in previous sections this Chapter and shows the evidence in appendices. Moreover, this study countered this problem by showing many case quotes. When does the GT iterative process end? In this study the sampling and coding process ends at theoretical saturation. In order to make sure there is no new information arises concerning the dimensions and properties of categories, this study conducted interviews more than those common in grounded theory studies. Moreover, the researcher presented the findings at some conferences, such as British Accounting Association (BAA) annual conference, and consulted some experts. Furthermore the research findings are sent

back to the interviewees. Because interviewees are interested in this topic and want get feed back from this study to improve their work. Their opinions help the researcher to make sure that the theoretical framework is well developed and correctly reflected their perceptions.

Another criticism to grounded theory is lack of generalizability. The quantitative scholars may doubt that how the findings can be generalized to other settings when fairly unstructured interviews are conducted with a small number of individuals in certain organizations or locations. Precisely, the criticism concerning theoretical sampling may be: how can a small number of cases can be representative for all cases? Problems regarding interview as a method in collecting data may be: can we treat interviewees who have been selected as representatives for those who do not participate the interviews?

In this study, theoretical sampling is adopted to maximize opportunities to discover variations among concepts and to densify categories in terms of their properties and dimensions (Strauss and Corbin, 1998). The cases selected are not a sample of a known population, which is commonly employed in quantitative studies. Similarly, the people who are interviewed in this research are not meant to be representative of a population. The findings of qualitative research are not to generalize on statistical reasoning but on "analytical generalization" (Yin, 2003). The statistical approach, also known as the distributive approach, is not suited for all types of research, for example when the population is heterogeneous, or when elements in that population are not all known. Yin (2003) rejects statistical generalization in qualitative studies and recommends a replication logic instead of a sampling logic that is aimed at statistical representativity. "Analytical generalization" means there is generalization from one case to other cases that belong to the scope of the theory involved. Theoretical sampling is applicable to the replication logic. This grounded theory study is aimed at analytical generalization. One cannot generalize from one case, especially in the quantitative sense of the word. However, one can learn a lot from the study of one factory or organization. This grounded theory research is studying concepts and their relationships. If the concepts are abstract enough, then they are likely to occur in similar or variant forms in other organizations. If similar conditions

exist in one's organization, then perhaps much of what we learned about it in this study may help one to understand what is going on in his or her organization as well. If they are different, then it is important to note how this changes the workflow. Although some of the concepts are well developed it can hardly be said that knowledge about them is saturated. The theory will be somewhat limited in explanatory power and will require expansion, modification and extension through other studies of work in similar and different types of organizations. Generalizability is still a limitation in this grounded theory study that will be discussed more in the conclusion chapter.

Furthermore, grounded theory method is criticized in terms of distorted form of disclosure, lack of researcher triangulation, and subjective interpretation. This study investigates the relationship manager's perceived value creation in relationship banking. The researcher argues that it is possible to get interviewees' perception by asking them. The interviewees are not necessary to cheat. If they do not want to disclosure their opinions they can just reject the application. Moreover, this study does not involve any very private or sensitive information and the participants are anonymous in the dissertation. However, there could be distorted disclosure because of interviewees' misunderstanding, lack of knowledge or experience. These study interviews relationship managers in different levels such as directors, senior managers, junior managers to maximize variation but also reduces distorted disclosure by any individual managers. Some managers in the same case bank are interviewed to cross check and compare information. Furthermore secondary data are employed to cross check information. In order to reduce subjective interpretation, the interviews are tape-recorded and the transcripts are sent back to the interviewees for checking. This study respond to the criticisms in terms of lack of researcher triangulation and subjective bias in processing data by consulting to experts and sending back to the interviewees. However, these criticisms are limitations in this study and discussed in the conclusion chapter.

In addition, grounded theory is criticized as lack of theory-neutral observation (Bulmer, 1979). Bulmer has questioned whether grounded theory researchers can suspend their awareness of relevant theories or concepts until a quite late stage in the

process of analysis. In grounded theory study, theoretical sensitivity is essential in specifying concepts and relationships among theoretical elements. Grounded theory researchers are typically sensitive to the concepts of their disciplines and it seems unlikely that this awareness can be put aside. Moreover, in many circumstances, researchers are required to spell out the possible findings or implications of their planned investigation. These subjective concepts in mind may influence the interpretation of data.

In this study the researcher argues that it is impossible to have a completely theory-neutral observation. The researcher needs experience and knowledge in a particular area and therefore to be interested in a specific social phenomenon and to find problems and research opportunities. It is desirable that researchers are sensitive to existing conceptualizations, and theoretical development can build upon the work of others. Strauss and Corbin's (1998) grounded theory uses existing literature or theory to specify the research questions and compare with the findings. In this study the grounded theory method is chosen because the phenomenon is not well researched and there is no comprehensive theory related to the particular phenomenon. It is necessary to develop some new theoretical elements and relationship among them to explain the phenomenon and get a better understanding. Therefore the existing literature has little influence on the development of grounded theory in this study. Moreover, the researcher does not have any planned findings and focuses on data to develop the theoretical framework and any theoretical elements are grounded on data.

There are also some criticisms of coding in grounded theory. Grounded theory is very much associated with an approach to data analysis. The data is fragmented by coding into discrete chunks, so that the narrative flow of what people say is lost (Coffey and Atkinson, 1996). Riessman (1993) realizes that some interviewees developed long account of what had happened and knotted together several themes into long accounts that had coherence and sequence. Therefore the researchers are not willing to fragment the long accounts into distinct thematic categories. Riessman (1993) suggests that some forms of data may be unsuitable for the coding method.

The coding method is employed in this study because it is useful to identify theoretical elements from data. The coding processes help the researcher to develop an integrated grounded theory of relationship banking. Moreover, the procedure is verifiable and therefore improves the creditability of this study. The coding method is wide accepted because of the influence of grounded theory and its associated techniques. The development and growing use of computer software for qualitative data analysis also increased the adoption of coding approach.

Although grounded theory is a well developed approach and wide accepted by researchers, there are some differences in its presentation and even clashes. Glaser (Glaser and Strauss, 1967; Glaser, 1978) develops the general method to generate theory from data. Strauss and Corbin (1998) take grounded theory in a different direction from what Glaser had outlined in Theoretical Sensitivity and the 1967 book. There was a clash of ideas between the discoverers. For example, Glaser and Strauss (1967) recommends reading widely while avoiding the literature most closely related to what you are researching because your reading may otherwise constrain your coding and memoing. However, Strauss and Corbin (1998) suggest that no researcher enters into the process with a completely blank and empty mind and therefore interpretations are the researcher's abstractions of what is in the data. These interpretations, which take the form of concepts and relationships, are continuously validated through comparisons with incoming data. Grounded Theory is divided into Strauss and Corbin's method and Glaser's method.

Moreover, Strauss and Corbin's (1998) methods are also different to other grounded theory ideas. These may cause some vague points or confusions in grounded theory research. For instance, Strauss and Corbin (1998) refer to theoretical sampling as sampling on the basis of emerging concepts but Charmaze (2000) writes that it is used to develop categories. There is an inconsistence of using key terms. Glaser and Strauss (1967) emphasize the interplay of data and researcher. Charmaze (2000) suggests that Glaser, Strauss and Corbin are objectivist in that a grounded theory study aims to uncover a reality that is external to social actors and neglect the role of the researcher in the generation of knowledge. Nevertheless, social reality does not exist independent of human action (Charmaz, 2000).

This study adoptes Strauss and Corbin's method because this method is well structured and verifiable. For example, in this study the researcher uses literature to identify problems. The interviews were tape recorded and verbally transcribed. The preliminary findings were presented at some conferences. These procedures are against Glaser's ideas but the researcher treats them as usful actions in developing the grounded theory.

Finally, there are some practical difficulties with grounded theory. First, access to the phenomenon and the people to do interviews or observations is necessary. Sometimes, it is not easy to get close enough to the phenomenon especially for those sensitive ones. Second, grounded theory researcher may have a difficulty of time constrains. Grounded theory study is quite time consuming in collecting qualitative data, transcribing recordings of interviews and processing data. Third, a high level of skill is needed in grounded theory study. It is hard for those not very experienced researchers, as theoretical sensitivity needs to be built on long time study in the particular area. Experienced researchers are good at developing theory because they have internalised this mode of thinking and can go about it less self-consciously. However it is difficult for beginners, especially with tight deadlines, to carry out a genuine grounded theory analysis with its constant interplay of data collection and conceptualisation (Bryman, 2004). Consequently, it is somewhat doubtful whether the grounded theory is well developed to be a dense and tightly integrated theory. Fourth, this dissertation employs quotes to illustrate the elements of grounded theory but the taped language text contains many grounded theory themes together. The readers may find that similar quotes are utilised in different chapters. For example, customer information and knowledge is treated as an intervening condition in chapter 6 and as an action in chapter 7 and mentioned frequently in chapter 8 as the main source of benefits. It is necessary to explain that the purpose of using quotes is demonstrating the identified grounded theory themes.

In this study, the researcher successfully contacted and conducted 22 interviews in 15 case banks. The case banks and interviewees are interested in this topic and kindly participated in this study. The researcher spent four or five years to conduct this study

and without a strict deadline. This is a good opportunity to conduct a grounded theory study. The researcher worked in a bank for many years and obtained degrees in relevant subjects. Holland (1993, 1994) has done field research to investigate the relationship banking process. He is one of the most experienced finance professors in using grounded theory and the researcher has benefit from his experience and skills, which he kindly has let the research benefit from. Professor Holland and Dr Kreander as PhD supervisors made great contributions in this study with their experience and expertise. The researcher has benefit from their experience and skills which the grounded theory findings have been presented in some conferences and sent back to the case banks to check if theory is well developed and helpful to understand the phenomenon. However, there always are problems of time and energy constrains, availability of participants and other conditions that affect data collection and process. These can impose limits on how much and what types of data are collected and how well the theory is developed. If the researcher stops gathering and processing data before theoretical saturation, then the theory might not be fully developed in terms of density and variations. Some times the researcher has no choice and must settle for a theoretical scheme that is less developed than desired.

Every method may have advantages and disadvantages. In this study the researcher argues that Strauss and Corbin's (1998) grounded theory approach represents a valid research method for conducting a qualitative research including data collection and analysis. Although it is arguable which grounded theory method is the correct one, many of its core process, such as coding, memos, and the very idea of allowing theoretical ideas to emerge out of one's data, have been hugely influential.

4.6 Conclusion

This chapter discussed the research methods in collecting data, processing data and writing up the thesis. The Strauss and Corbin's (1998) grounded theory approach is adopted in this study. Data is systematically collected and processed according to the grounded theory methods. In order to maximize opportunities to discover variations among concepts and to define categories in terms of their properties and dimensions, data collection in this study is guided by theoretical sampling, by which data

gathering is driven by concepts derived from the evolving theory and based on the concept of "making comparisons." Interviews are utilised to collect qualitative data and other methods such as searching archives to collect secondary data. In this study theory is derived from data that is analysed in line with grounded theory (Strauss and Corbin, 1998) procedures including open coding, axial coding and selective coding. The presentation of developed theory follows a format that involves the telling of theoretical elements and the showing of data fragments that instance them (Locke, 2001).

The grounded theory (Strauss and Corbin, 1998) approach is a well-structured qualitative research method. It helps the researcher to successfully collect data and derive a grounded theory. However, there are some weaknesses concerning this method. Grounded theory approach is criticized as too subjective, lack of generalisability and neutral-observation. There are also difficulties in practice especially for those who are not very experienced researchers with time constrain. For example, it is relatively easy to understand the logic of theoretical sampling. But sampling must be practiced by doing actual research investigations. Sampling is completed when categories are saturated in terms of properties and dimensions. Nevertheless, sampling may continue right until the writing up because sometimes the researcher might discover that the particular categories were not fully developed. Theoretical sensitivity is emphasized in the methods of processing data. Theoretical sensitivity needs to be developed through a literature review and previous experience.

The next four chapters present the findings. Chapter 5 provides an overview of a grounded theory of relationship banking using a paradigm model. The paradigm model shows the theoretical elements and the connections among them. The chapters thereafter present these categories in detail. Case quotes are used in the chapters to illustrate these elements. These chapters also describe how the data documents were approached to derive conceptual categories. The relevant literature is employed to compare and contrast with the findings.

Chapter 5 An Over View of a Grounded Theory of Relationship Banking

5.1 Introduction

The previous chapter discusses the research methodology and research methods utilised in this study. Grounded theory is an inductive, theory discovery method that allows the researcher to develop a theoretical account of the general feature of a topic while simultaneously grounding the account in empirical observation or data. The grounded theory approach is used to create inductive theory. This chapter presents the overview of a grounded theory of relationship banking using a paradigm model. The paradigm model reveals how the grounded theory elements are connected, and thus provides a "map" to steer through the ensuing detailed results of the fieldwork and the processing of fieldwork data in Chapter 6, 7 and 8. It should however be noted that the "paradigm model" is an aggregate "result" of these detailed results on data processing. Case quotes are used in the thesis to illustrate these elements through interviewees' voices and narrative and thus ground the model explicitly in the case data. It also describes how the data documents were approached to derive conceptual categories.

5.2 A paradigm model of relationship banking

Locke (2001) comments that "the presentation of grounded theories similarly follows a format that involves the telling of theoretical elements and the showing of data fragments that instance them" and "This format can be outlined as: summarise the theoretical frame –serially present each theoretical element well illustrated with data instances –summarise the theoretical frame." In this chapter the theoretical frame of the grounded theory model of relationship banking is presented as a ''paradigm model' as recommended by Strauss and Corbin (1998). This is a conceptual analytic device for organising data and for integrating structure with process and for summarising the grounded theory of relationship banking. It links six broad modelling ideas of phenomenon, context, causal conditions, intervening conditions, action or interaction strategies and consequences.

In Strauss and Corbin (Chapter 7, 1998) these are defined as follows.

- Phenomenon: The central idea, event, happening, incident about which a set of actions or interactions are directed at managing, handling, or to which the set of actions is related.
- Context: The specific set of properties that pertain to a phenomenon; that is, the location of events or incidents pertaining to a phenomenon along a dimensional range. Context represents the particular set of conditions within which the action / interaction strategies are taken.
- Causal conditions: Events, incidents, happenings that lead to the occurrence or development of a phenomenon.
- Intervening conditions: The structural conditions bearing on action / interaction strategies that pertain to a phenomenon. They facilitate or constrain the strategies taken within a specific context.
- Action strategy: Strategies devised to manage, handle, carry out, and respond to a phenomenon under a specific set of perceived conditions.
- Consequences: Outcomes or results of action and interaction.

These general grounded theory terms are used here as a convenient language to provide a brief initial overview of the grounded theory prior to presenting the findings. However, there are problems in using the grounded theory language from Strauss and Corbin (1998). It is hard to differentiate context with macro conditions and micro conditions with consequences. The grounded theory of relationship banking in this dissertation is actually the main themes and their connections. These same themes will be presented in later chapters, for example in process and structure model of relationship banking in figure 7.2 and in figure 9.1. The paradigm model here provides a broad picture that matches phenomena as it appeared in the cases. This is perceived value creation process in relationship banking by case bank interviewees. Diagram 5.1 illustrates the paradigm model of a grounded theory of relationship banking.

The phenomenon of interest in this investigation was a subset of corporate banking, named Relationship Banking. In this dissertation relationship banking was seen as a

business strategy to establish long-term relationships with selected corporate customers in a financial institution. This view was based on the perception of the interviewees. The context of this study was the active market for corporate banking services made up of banks, corporate customers, and employees as producers and shareholders as owners.

The causal conditions were separated into macro and micro conditions. The external macro factors drive uncertainty and increase information gap in corporate banking for banks and customers. Micro factors are learnt driver whereby bank learns that relationship banking can deal with these external problems. Both of macro and micro factors drive the adoption of relationship banking.

The causal macro-conditions influencing the adoption of relationship banking included advances in technology, financial deregulation and business globalisation.

The case banks perceived that advances in technology increased speed and lowered costs of computing and telecommunications. As a result the case banks were able to offer a broad array of products and services to large numbers of customers over wide geographic areas. Financial deregulation allowed the case banks to provide the full range of financial products and services, opened up many new markets, both in developed and in transition economies. Business globalization of non-financial corporations created an international demand for financial products and services for the case banks. These environmental changes had increased competition in corporate banking market both from domestic non-bank financial institutions and foreign banks. Greater competition in turn diminished the cost advantage the case banks had in acquiring funds and helped to squeeze profit margins. However, these macro-conditions also provided great opportunities for the case banks. The rapid development of information technology provided an effective solution to collect and process customer information. Therefore the case banks managers could quickly identify customer needs, design and implement customized solutions promptly. Financial deregulation enabled the case banks to provide tailored products and services to meet the needs of specific customers.

The micro factors are learnt by the banks over time. A key micro causal factor was the bank need to satisfy its basic function of supplying banking products and services to the corporate sector. The case banks learnt over time that this need or function was best delivered through relationship banking.

The banks also learnt that certain key micro factors including risk management, cost effectiveness and exploration of cross-selling were critical to making relationship banking attractive for the case banks. Thus historic bank understandings or learnt priors concerning these micro factors were perceived as key causal factors in driving relationship banking.

In order to reduce credit risk, the case banks learnt that knowing the customer and understanding their businesses were essential for making decisions. The interviewees argued that keeping a customer was more cost effective than acquiring new customers. Corporate customers would purchase several products and financial services from the banks and some of these products and services were purchased very often. Therefore establishing long-term relationship with corporate customers made it possible for the case banks to explore cross-selling opportunities.

The intervening conditions were structural conditions based on bank-customer relationships and included bank knowledge of customer, customer needs and customer confidence.

The interviewees perceived that customer information and knowledge was essential in corporate banking. The case banks wanted to acquire customer information and knowledge and therefore established long-term relationships with corporate customers. The interviewees thought that the corporate customers wanted to establish long-term relationships because of the characteristics of customer needs. Furthermore, customer confidence was very important and expected to be built on long-term relationships. Every company would have bad times at some points. The case banks perceived that the corporate customers wanted to make sure that the bank would help them when they had financial difficulties.

The actions/interactions were separated to strategic and ongoing categories. The strategic actions/interactions created context and foundation for ongoing actions/interactions.

In the case banks the strategic actions/ interactions included relationship orientation, customer-centric organization, customer value based performance measurement, incentive-based compensation.

A relationship orientation was a strategic choice of corporate culture that the case banks treated the customer relationship as a source of competitive advantage. Customer-centric organizational structures provided a foundation for developing and implementing this culture. A customer value-based performance measurement and incentive-based compensation system was also important for relationship banking in the case banks. The Balanced Scorecard[15] approach was increasingly implemented in the strategic performance measurement system combining qualitative and quantitative indicators. Incentive-based compensation motivated relationship managers to build and maintain these trust-based personal relationships with corporate customers.

In the case banks the ongoing action /interactions included trust-based personal communications with customers, internal cooperation within the team and among divisions, exchange of information with customers, and relationship transactions.

The nature of bank-corporate relationship was trust-based personal interactions. The case banks established personal relationships through multi-level communications. Customer-centric organizational structure enabled cooperation within the team and among divisions. Relationship-oriented banks made sure that the collected customer information was shared across the organization.

The case banks exchanged information through regular contacts with corporate customers. The trust-based personal interaction enabled the case banks to gain more private information. Customer information was integrated from multi-channel

[15] A model of business performance evaluation that balances measures of financial performance, internal operations, innovation and learning, and customer satisfaction (Kaplan and Norton, 1996).

communications and shared within the teams. The employees were provided with a single view of the corporate customer. A great effort was made to obtain customer information, understand customer business and identify customer needs.

By having more customer information and knowledge the relationship identified customer needs and fulfil their needs with suitable products and high quality services. The case banks have built trust overtime. This provided significant processing efficiencies and ultimately enabled the managers to make a quick decision. Moreover the case banks explored cross-selling opportunities to get more revenues. Internal cooperation within the team and among divisions made sure that the solutions were delivered properly.

The consequences were divided into customer and bank consequences. The intended consequences or benefits of relationship banking for the customer included credit availability, product availability, and service quality, in-time help and business platform. The intended outcomes for the case banks included information the reduction of credit risk, increase in income, sustainable profit, customer satisfaction, and employee satisfaction.

Relationship banking was perceived to be of mutual benefit for both customers and the case banks. Providing more information helped the case banks to evaluate credit risk and make decisions, and consequently customers got a quick response. The interviewees perceived that relationship customers were able to get more funds. Moreover the relationship managers believed that they developed tailored solutions and priced the financial products and services properly. Keeping a long-term relationship with a reliable bank was perceived as vital to customer. They received in-time help when they had financial problems. The case banks worked together with customers to resolve the problems before financial insolvency occurred. The relationship managers also introduced some business opportunities among their customers. These benefits improved customer satisfaction and customer retention rate.

Regular communications and consistent commitments helped the case banks to build trust with customers and gain an information and knowledge advantage in the competitive financial markets. By understanding customers' business the case banks reduced credit risk and by gaining more information and knowledge of customers' business the case banks were able to quickly respond to their financial requests and explore cross-selling opportunities. In addition, customer retention was more cost effective than customer acquisition. Therefore the case banks increased their profit.

The case banks gained sustainable profitability by keeping their good employees because the employees were a source of sustainable competitive advantage that could not be duplicated by the competitors. The employees had personal relationships with their customers and great capability to create customer value. The customer value based performance measurement and incentive based compensation developed this sustainable competitive advantage.

The increase of customer satisfaction enabled the case banks to keep the customers and explore cross-selling opportunities. Keeping good experienced employees improved the capability of credit risk management and cost effectiveness. This was perceived as a dynamic learning process in the organisation. It fed back into bank level understanding of the micro factors driving relationship banking.

5.3 Conclusion

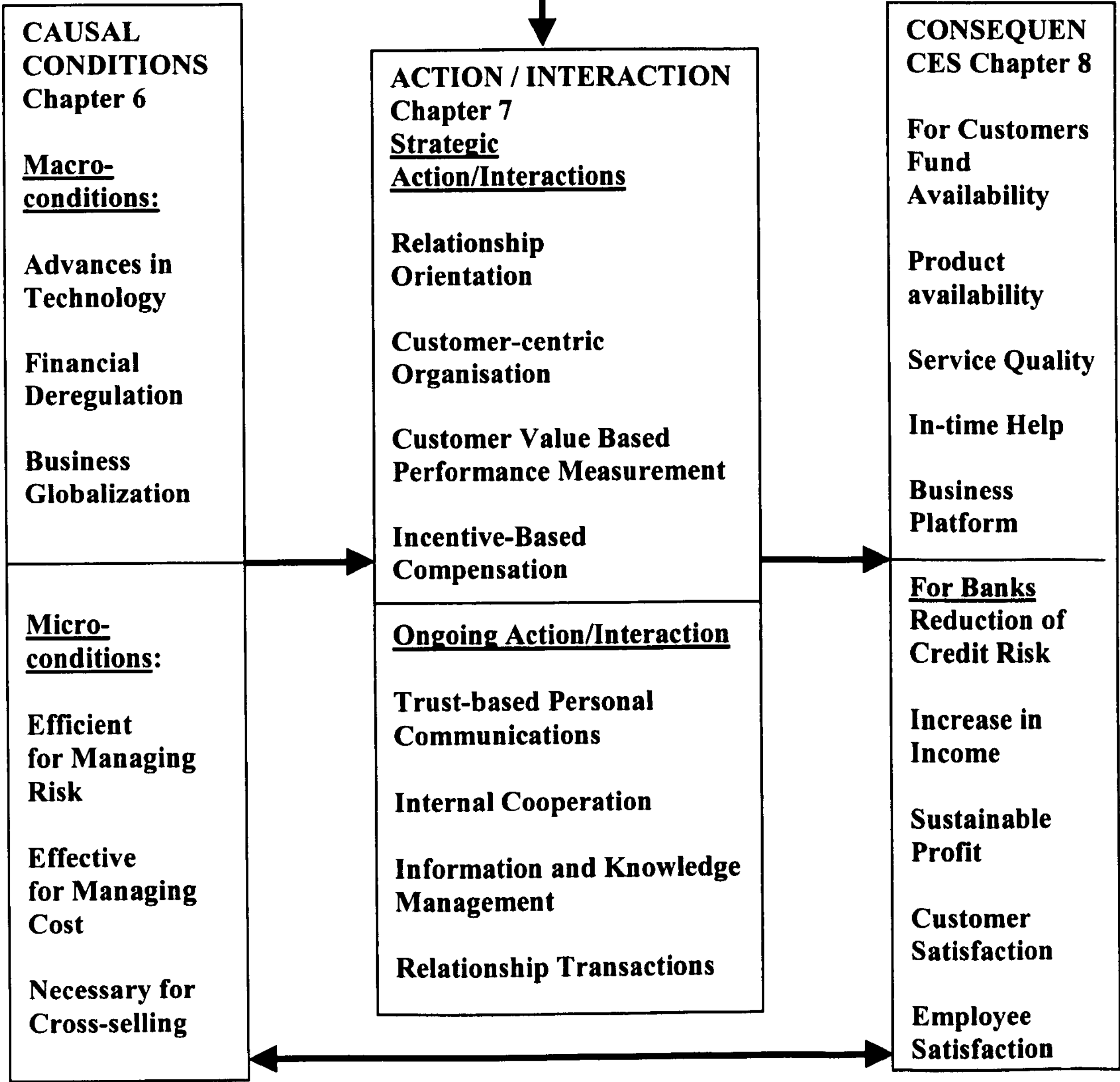
This chapter offered an overview of the grounded theory of relationship banking by employing a paradigm model which links six broad ideas of phenomenon, context, causal conditions, intervening conditions, action/interactions and consequences. The following chapters will present these theoretical elements in detail.

CONTEXT - Corporate Banking Market
(Corporations, Banks, Managers and Shareholders)
Chapter 6

CENTRAL PHENOMENA –Relationship Banking

Diagram 5-1.
A Paradigm Model of Relationship Banking

INTERVENING CONDITIONS - Customer Information and Knowledge
Customer Needs
Customer Confidence



Chapter 6 Context of the Study and the Causal Conditions of Relationship Banking

The director of commercial banking in a UK based bank A commented.

> "The environment in the banking industry is more and more competitive. Customers can choose any bank to do business with. Why they choose us is because we have a relationship and they know we can help them. By establishing close relationships we can know the customers well and understand their business. We will make important decisions on lending products because we have built trust over a number of years. We have opportunities to meet customers' needs and sell additional products and therefore gain more income from the connection. It is far more cost effective to keep customers than to start a massive campaign in terms of acquiring new customers. The satisfied customers are very good advocates for the bank." ULAD

The above quote summarises some of the causal conditions influencing the adoption of relationship banking in the case banks. These causal conditions were factors that the case banks considered when they adopted relationship banking as their business strategy in corporate banking.

6.1 Introduction

The previous chapter provides an overview of the grounded theory of relationship banking and introduces the paradigm model which links six broad ideas of phenomenon, context, causal conditions, intervening conditions, action or interaction strategies and consequences. This chapter discusses the context, macro conditions, micro conditions and intervening conditions of the corporate banking market within which the grounded theory case study was conducted. The external macro factors drive uncertainty in the corporate banking market for banks and customers. The case banks must develop strategies in changing and uncertain environments. These environmental changes influenced the way of providing financial products and services and the way in which corporate customers were managed.

The above quote shows that the bank managers believed that the corporate banking market was more and more competitive. Relationship banking was adopted to reduce competitive pressure in the corporate banking market. Micro factors are that banks learnt that relationship banking could deal with these external problems and exploit opportunities. More pressure came from non-bank financial institutions and foreign banks because of the advances in technology, financial deregulation and globalisation. Meanwhile these environmental changes in the corporate banking market facilitated the case banks to collect and process customer information and identify customers' needs. Moreover the case banks could meet customers' needs with a variety of financial products and services. In order to understand customers' business and make decision on funding, and reduce cost and get more incomes from cross-selling, the case banks adopted relationship banking as a good way to do business with those profitable corporate customers. This chapter discusses the context of the research and the causal conditions of relationship banking.

6.2 The context and macro-conditions of relationship banking

The context is a specific set of properties that pertain to the phenomenon. It represents the particular set of conditions within which the action / interaction strategies are taken. The causal conditions are those events or variables that lead to the occurrence or development of the phenomenon. It is hard to distinguish context from the causal conditions especially macro causal conditions. Therefore this dissertation discusses the context and macro conditions together. The context and the causal macro-conditions influencing the adoption of relationship banking included the advances in technology, financial deregulation and business globalisation.

The advances in technology facilitated the case banks' ability to communicate with corporate customers, collect and analyse customer information. Technological advances combined with financial deregulation have enabled the case banks to offer a broader array of products and services to larger numbers of clients over wider geographic areas. The business globalisation increased the competition in financial markets meanwhile gave the case banks opportunities. Considering these factors the

case banks established long-term relationships with those customers to respond to the increased competition and explore the opportunities.

These macro condition themes derived from the case are discussed in the following sectors.

6.2.1 Advances in technology

A director of commercial banking in the UK based multinational bank N remarked that.

> "By applying for the online banking and telephone banking services, in a simple, convenient and secure way, you can keep a close eye on your balances on all your accounts including credit cards, payments and transfers. You can also pay bills and transfer money at the touch of a button." UMND

> "We harness the power of technology to change the way we do things for customers and for ourselves. Information technology has given us the means to analyse and assess credit and market risk much more accurately than ever before." UMBD

A majority of interviewees claimed that the advances in technology significantly influenced the case banks in corporate banking. For example, the above quote shows that the development of information technology facilitated the case banks capability to provide financial products and services for customers and cooperate with internal groups. Due to information technology the case banks collected and analysed customer and market information more efficiently.

Frame and White (2002) also argues that banks are intensive users of both information technology and financial technologies. Information technology (IT) refers to the innovations in information processing, telecommunications, and related technologies. Financial technologies include using economic and statistical models to create and value new securities, estimate return distributions, and make portfolio decisions based on financial data. For example, financial engineering is used to create new financial derivatives, credit risk and market risk models are employed to improve

portfolio management, and modern credit scoring and discriminate analyses are used to evaluate credit applications. These financial technologies often depend heavily on the use of IT to collect, process, and disseminate the data.

The development of information technology has contributed to some banking technologies including Internet banking, electronic payments technologies, and information exchanges (Berger, 2003). Banks offer a variety of levels of Internet service and combinations of Internet and physical offices and ATM networks. Electronic payments technologies are methods of transferring funds electronically with relatively little paperwork. Information exchanges are intermediaries through which banks and other creditors share data relevant to the creditworthiness of loan applicants.

Moreover, the interviewees explained that the advances in technology influenced the case banks on customer relationship management. For example, the chief executive of business banking in a US based multinational bank C noted that technology was critical to the development of customer relationship management in corporate banking.

> "Customer Relationship Management (CRM) has become a very important part of corporate strategy and business practice in today's competitive world, especially in service related industries, such as banking, insurance and investment banking. Theoretically, the CRM concept has existed for decades, but it emerged to centre stage in the late 1990s along with the rapid development of the IT industry in developed countries. In the real business world, the Pareto principle of 20/80 really works. In order to achieve sustained business growth, all business executives need to find a way to retain and expand their top-20 client base. A computer-supported CRM system provided an effective solution to that. By gathering and distributing information at an unbelievable speed, a business manager can quickly identify the client's needs, design and implement customized solutions promptly." SMCD

> "In 2001, our bank announced the development of a new customer relationship management system. We believed that through innovative technology we would be providing our customers newer and much better ways to manage their financial lives. In 2003, our bank was named one of the winners of the annual Best Practice Award. Our enterprise data warehouse stores customer, account and transactional

information from 180 systems in one place and is a key component of the important "Know the Customer" and "Customer Relationship Management initiatives." SMCC

The above quote emphasizes the important role of information technology in the adoption of relationship banking as their business strategy. The CRM concept was more and more popular in the later 1990's because of the development of information technology. The interviews perceived that the advances in technology increased the efficiency of gathering, processing customer information and designing and delivering tailored solutions for the customers. Therefore it facilitated the adoption of customer relationship management in the case banks.

Some other scholars also support the argument that the advances in technology improved the efficiency of banking management. Bauer and Higgins (2002) conclude that the advances in technology can accelerate financial sector development by lowering the costs, increasing the breadth and quality, and widening access to financial services. Technological progress increases economies of scale in a variety of bank products and services, such as payments processing, cash management, and bank office operations. Technology advances leads to the development of new products and services that have more scale economies than traditional banking products. The advances in IT permit personalized pricing of financial services and much more effective identification of credit risks.

The improvements in bank performance during the deployment of new technologies suggest that IT advances appear to have increased productivity and scale economies. Berger (2003) finds that for the 1990s after controlling for exogenous market conditions, bank cost productivity declined but profit productivity improved. These findings suggest that technological progress resulted in improved quality and variety of banking services that increased costs, and that customers could pay for these improvements so banks were able to raise revenues sufficiently to more than cover the higher costs.

Furthermore, the advances in technology increased the competition in corporate banking market. The case banks adopted relationship banking by means of

responding to this increasing pressure. Thus the advances in technology increased the competition in corporate banking and made relationship-banking strategy more necessary. For example, two regional directors of corporate banking in the UK based multinational banks remarked that.

> "The rapid convergence of information and communication technologies is altering radically Bank H's range of competitors. Specialist providers and non-financial organizations are now able to deliver a diverse range of financial services across a variety of electronic channels without the need for a traditional branch network. These innovations increase the pressure on established banks to enhance service quality while also investing in the provision of similar services." UMHD

> "The developments in technology are significantly expanding bank L's range of competitors. These new entrants are expected to put Bank L's margins under increasing pressure. Furthermore we expect that competition within the industry will continue such as selling across the Internet. Bank L has significant strengths with which to counter the pressure such as on its margins by its relationships with existing customers and its distribution capability." UMLS

As showed in the above quotes the case bank managers perceived that the development of IT and financial technology increases the competition in corporate banking market. The case banks were facing more competition from foreign banks because the development of information technology. For example foreign banks provided Internet banking to compete in the local market. In addition more competition came from non-bank financial institutions and non-financial organizations such as supermarkets. Because of the financial deregulation, which will be discussed in next theme, these organizations were free to provide financial products and services that were traditionally offered by the case banks. The advances in technology facilitated these organizations to compete with the case banks. Branches have been seen as a barrier to entry since the development of branch networks requires large sunk costs. Information technology provides an alternative, lower-cost way to reduce sunk costs and barriers to entry in the banking market.

Therefore, the case banks were facing more competitive pressure from a broad range of competitors and seeking to differentiate themselves. As a result the case banks

selected customer relationships as a source of competitive advantage. For example the head of marketing and strategy of an Ireland based Multinational bank I, and a senor relationship manager from UK based multinational bank L remarked.

> "We have faced the challenges posed by a competitive environment over the years. We believe competition is good for the consumer and good for our business. There is still some way to go to reach that goal and Bank I intends to play an active part in the dialogue with customers that will shape a cost-effective, competitive and consumer-friendly environment." IMIH

> "We have nothing to compete on, therefore we establish long-term relationships to differentiate ourselves. The customer relationship is our competitive advantage." UMLS

The development in information technology increased competition in the corporate banking market and influenced the case banks to establish customer relationships as a source of competitive advantage. The case banks reduced competition pressure and took advantage of opportunities through these business relationships.

A similar conclusion is also suggested by Northcott (2004). Claessens, Glaessner and Klingebiel (2002) argue that first information technology improves price transparency and therefore increases competition and reduces profit margins. Second, competition comes from other financial institutions including payment and brokerage services, mortgage loans, insurance, and even trade finance companies. Many of the services traditionally provided by banks are being provided by other entities. Third, IT can further expand the geographical scope of competition. Foreign financial service providers with a competitive advantage in information technology are entering the market across borders.

Vesala (1998) suggests that the emergence of remote banking leads to an increase in price competition and banks need to find another way to differentiate themselves. Boot and Thakor (2000) presents a model in which banks can engage in both relationship and transactional lending. They argue that banks may actually do more relationship lending in a competitive environment. These findings support the argument that the advances in technology were a causal condition of relationship

banking. Information technology helped the banks to meet the variety of customer needs and keep them longer. The case banks could create and tailor products without much human input and at very low cost and better satisfy their customers.

However, the findings in this study are opposite to some literature. Some researchers argue that the advances in technology make it increasingly easy for banks to remain at "arm's length" from their borrowers (Petersen and Rajan, 2002). Boot and Thakor (2000) suggest that increased competition can reduce the incentive for banks to forge long-term relationships with customers.

In general, the advances in technology gave the case banks both challenges and opportunities. IT investment does not mean by itself increases in efficiency. However, an important efficiency source may be in the proper use of the equipment. The case banks took advantage of information technology to support their relationship banking strategy.

6.2.2 Financial deregulation and corporate banking market changes

The interviewees mentioned that the case banks faced more competition then ever before from non-bank financial institutions. Because of financial deregulation these organizations provide banking products and services. For example the director of business banking in an Ireland based multinational bank I commented.

> "It is important to recognize that competition is extremely tough at the moment; there are many banks and financial services organizations. We are undoubtedly going through a period of great change at the present time where the regulatory and governance circumstances are developing rapidly. We support a well-managed regulatory environment in the financial services sector. But there are serious costs associated with regulation. We are facing more competitors in the financial market."
> IMIH

Another director of corporate banking in the UK based multinational bank H explained in detail.

> "Bank H faces more competition in all the markets it serves. It competes in the provision of commercial banking products and services with other major financial institutions, including commercial banks, building societies, insurance companies, post offices, credit card companies and investment companies. In investment banking, Bank H faces competition from both pure investment banks and the investment banking operations of other commercial banks." UMHD

The above quotes indicate that many non-bank financial organizations provided banking products and services under the reformed financial regulation. Therefore the case banks were facing more competitive pressures from these non-bank financial organizations. All financial institutions were free to choose their products and services range. The financial organizations provided similar products and financial services. The prices were more transparent and the profit margins were reduced because of the information technology and increased competition. As a result it was very hard for the case banks to differentiate them in corporate market and find competitive advantages in prices and products. For instance a senior relationship manager of corporate banking in the UK based multinational bank L commented.

> "If you accept in the majority of cases, the products provided by financial services companies are broadly similar, there might be small differentiations of price; there might be small differentiations in the features or benefits. But broadly customers, if they are looking for financial services and products, will probably rely more on the services they get from the financial services organization rather than just the individual product's structure." UMLS

The above quote and similar statements from other banks demonstrate that the financial institutions provided similar products and services and had few differences in price. It was hard for the case banks to take competitive advantages in product and price. Moreover the customer relied more on product package and service quality rather than individual product and price. The case banks were more focused on product package and services quality. As a relationship manager in an Ireland based large bank N remarked.

> "What we are looking to do is have a broader range of products, have a broad range of capability. We are a true relationship bank and have a range of finance packages to give you flexibility in reaching your business potential. We can help you arrange

> an insurance package tailored to your business needs. As a relationship bank we aim to bring a seamless "one-bank" service to all our customers. Our business areas work with each other, providing the right mix of expertise to deliver optimal solutions to your business." ILNG

This interviewee argued that the case bank provided a broad range of capability therefore they were able to offer optimal solutions. In addition the case bank focused on service quality including flexibility, solution delivery. Financial deregulation had an important role to play in delivering tailored solution. Besides traditional commercial banking products and services, the case banks were allowed to provide security underwriting, insurance and other financial services because of financial deregulation. They provided a full range of financial products and services and delivered tailored solutions to the customers. As a result, the case banks improved customer satisfaction and maintained customer relationships and received more incomes.

The interviewees believed that establishing long-term relationships gave the case banks more chances to explore cross-selling opportunities. Cross-selling will be discussed later in this chapter. Therefore, the case banks chose relationship banking as a way to differentiate themselves in the more competitive corporate banking market. For example a director of corporate banking in the UK based multinational bank S concluded.

> "Therefore you need to look at the way in which you can package the services from your customer through a relationship rather than on a transactional basis." UMSD1

Furthermore, a senior relationship manager in the UK based multinational bank L explained the dynamic process in detail.

> "As your relationship managers we listen to what your business is and we should be able to give you a tailored product because we are a large bank and have a full range of financial products and services. We also design a suitable product for you. I understand your business and would tailor something to meet your needs. It may be a financial product or maybe just information. We can tailor our product but we also

feed in information and help you. That's to me again adding value to our relationship." UMLS

The above quote illustrates why the case bank chose customer relationship as a source of competitive advantage and relationship banking as a business strategy. Because of financial deregulation the case banks were able to provide suitable products to meet customer needs and improve customer satisfaction. It was easier for the case banks to maintain their relationships with satisfied customers. By keeping the customers longer, the case banks could get more information and knowledge to understand the customers business and identify customers' needs. By delivering tailored financial solutions to the customers the case banks satisfied the customers and maintained their relationships with the case banks. There seemed to be a link between long-term relationships and customer satisfaction.

Some other researchers provide evidence that financial deregulation influences the corporate banking market and the way of banks to do business. Carter et al. (2004) shows evidence that financial deregulation has increased competition in the banking industry. In the more competitive banking market, the relationships between the multi-product banks and firms can be used to deter entry of other banks (Yafeh and Yosha, 2001). By sharing the surplus from the relationship appropriately the multi-product banks can discourage customer defections to the arm's length market and therefore prevent entry of rivals. Thus a banking system with close ties between firms and banks will tend to perpetuate itself once it is in place.

DeYoung et al. (2004) argue that deregulation and technological change have transformed the banking industry into two primary size-based groups. The first group is comprised of very large banking institutions, characterized by the use of ''hard'' information, impersonal relationships, low unit costs, and standardized loans. The second group is made up of small banks, characterized by the use of ''soft'' information, relationship development, higher unit costs, and non-standardized loans. They suggest small banks are expected to make use of soft information to specialize in products and services that are more personalized, while large banks should make use of hard information to specialize in standardized products and services. However

this research finds that these large banks also established long- term relationships with corporate customers to obtain customer information.

In general, financial deregulation gave the case banks both challenges and opportunities. It was difficult for the case banks to find competitive advantages in single products and prices. Therefore the case banks chose customer relationship as a resource of competitive advantage and adopted relationship banking as their business strategy within corporate banking. With financial deregulation the case banks provided a wide range of products within a single institution. The interviewees perceived that this also facilitated them to develop close relationships with corporate customers by meeting the variety of needs. Maintaining close relationships helped the case banks to get more information and understand customers' business. Therefore it was not the financial deregulation itself caused the relationship banking but it was one of the important factors that case banks considered and employed in adopting and implementing relationship-banking strategy.

6.2.3 Business globalization

The interviewees perceived that business globalization affected the case bank dramatically in corporate banking market during the last two decades. It was one of the important factors to be considered when the case banks chose their business strategy. Therefore business globalization was seen as a causal condition for adopting relationship-banking strategy in the case banks.

In this dissertation, globalization is defined as the increasing liberalization and integration of economies in terms of trade and investment (Hausler 2002). It includes globalization of financial market and corporate customer business. Globalization of finance is in many respects a by-product of technology and deregulation. Technological advances have lowered computing costs and telecommunications, while at the same time greatly expanding capacity, making a global reach economically more feasible (Clarke, 2001). Deregulation, meanwhile, has opened up many new markets, both in developed and in transition economies (Weller and Hersh,

2002). More and more large companies are becoming multinational corporations because of international trade and direct investment in foreign countries.

On the one hand, the case banks faced an intensive competition in corporate banking market because of globalization. For instance a director of corporate banking in the UK based multinational bank H commented.

> "The trend towards bank consolidations, at both the national and international levels, is creating a broader range of banks capable of competing directly with Bank H in an increasing number of markets worldwide in which previously only bank H and a few other global banks offered the full range of banking services." UMHD

As mentioned above, financial globalisation forced the case banks to face a more intensive competition. The increased presence of international financial intermediaries, mainly foreign banks, in local markets increases the competition.

Moreover, some local corporations use international financial intermediaries although these international financial intermediaries are located outside the country. One example of the latter channel is the trading of local shares in major world stock exchanges. Large companies with undisputed access to capital markets around the world would receive frequent proposals from bankers, and before long they began to deal with several. The case banks now had to make great effort to compete for acquiring and maintaining customers and for businesses. For example a relationship manager of an Ireland based large bank N stated.

> "Competition is intensifying. Our customers have more choice than ever before. This keeps us sharp, for if we do not serve their needs effectively, they will look elsewhere. A priority is to differentiate our services to provide greater value to customers and to ensure that they do not want to turn to our competitors." ILNG

The above quote illustrates that the corporate customers had more options. They could get funding from local banks and financial institutions, foreign banks and international capital market. It was very hard for the case banks to acquire and keep corporate customers. Therefore the case banks have to focus on customers tightly and

make great effort to maintain their customers. Relationship banking was seen as a good way to do business under this situation. A director of corporate banking in the UK based multinational bank B commented.

> "The big challenge for corporate banking is the increasing competition from foreign banks and other financial institutions and the changing demands from customers. We were working in a quite relaxed environment before but now we have to focus on customers tightly. We were waiting for our customers to visit in our office before but now we need to contact them actively and invite them to join us. We expect to increase the proportion of profit contribution from value-added relationship products and services." UMBD

Therefore the case banks chose relationship banking as their business strategy to respond to the increasing competition from foreign banks and other financial institutions and the changing demands from customers.

Furthermore, the globalization of customers business forced the case banks to expand their business internationally. In order to meet customers' special needs, some of the case banks especially multinational banks developed international banking products. For example, a senior relationship manager in the UK based multinational bank L remarked.

> "A lot of customers just want a traditional loan and overdraft. Some of them want something different. They are exporting or expanding to China, maybe they need a special international product. You have to bring someone who has knowledge from the international department. Then they will provide us with a special product for him (the customer) exporting to China. I will find out information because I understand my customer and we will design a product, maybe suitable for a Chinese supermarket or whatever. We would tailor something to meet someone's need whether it is a financial product or maybe just information. Because we are a big group with offices worldwide we maybe able to help him. If you go to see someone in the Chinese Embassy in London, the trade embassy, then you will get the information. We can tailor our product but we also feed in information and help him. That's to me again adding value to our relationship." UMLS

As mentioned above the case bank had a worldwide network and provided international banking products and international information services for corporate customers. Because of business globalization the customers needed special support. If the case banks could not provide international products and services, the customers were not satisfied and might leave the case bank and look for help to other banks. Therefore expanding globally and developing international financial products and services were very important for the case banks to satisfy the customer needs and maintaining customer relationships.

The literature also emphasized the international nature of corporate customers' financial needs, and the importance of providing international financial products and services. Calomiris and Karceski (1998) argue that non-financial corporations increased the geographic scope of their operations. They created a demand for intermediaries to provide products and services attuned to the international nature of their operations. Global banking proliferated during the 1980s and 1990s as a result of a great increase in demand from companies, governments, and financial institutions (Biles, 2004).

One the other hand, globalisation provided the case banks opportunities to find new markets and new area to obtain more revenue. For example a director of corporate banking in the UK based multinational bank B claimed that:

> "A more open world order, alongside the creation of regional economic blocs such as the EU, has broken down many barriers to cross-border banking. Information technology and the worldwide web have also accelerated the foundation of a global market for many financial services. The financial services industry everywhere is reshaping itself to compete in this global market. To take advantage of these opportunities we have to be clear about those businesses which are likely to become global, for example, investment banking and institutional asset management are increasingly global. We expect several markets outside the UK to have good long-term potential for growth. Our business development over the next 10 years will be biased towards increasing our profit stream from outside the UK." UMBD

The above quote emphasizes the opportunities for the case bank because of globalization. In particular some new transitional markets provided more potential for

growth. In addition, globalization provided the case banks more international business. For example a relationship manager in the UK based multinational bank R stated.

> " ... When these needs include supporting a customer's business outside the UK, we provide full support. We have a real focus on building long-term and successful business relationships. We understand what is important to our customers and offer a comprehensive product range with the flexibility to tailor individual solutions." UMRR

The above quote illustrates that in order to build and maintain customer relationships the case banks had to provide international banking to meet customers' needs. In turn this new business gave the case banks more opportunities for growth.

In general, the globalisation of financial market and corporate customers' operations influence the case banks significantly. On the one hand, the case banks faced challenges from more intensive competition and more complex customer demand. Under this situation the case banks chose customer relationships as a resource of competitive advantage. On the other hand, the case banks had more opportunities to find development potential from new market and design new international products and financial services. Maintaining long-term relationships with corporate customers the case banks obtained growth opportunities and new businesses. Under the condition of globalisation relationship banking was feasible for the case banks to meet the challenge and take advantages of the opportunities.

6.3 The micro conditions as causal factors in relationship banking

These macro-conditions had a significant effect on the case banks. The interviewees believed that the customer relationship was a source of competitive advantage in this competitive corporate banking market. Relationship banking was chosen as a business strategy to meet the challenge and explore the opportunity. However from the relationship manager's point of view some micro factors and intervening conditions were more important than macro-conditions and made relationship

banking necessary in corporate banking. When the case banks chose relationship banking as their business strategy they considered these factors.

A key micro causal factor was the bank need to satisfy its basic function of supplying bank services to the corporate sector. The case banks learnt over time that this need or function was best delivered through relationship banking. The case banks also learnt that certain micro factors including risk management, cost effectiveness and exploration of cross selling, were critical to making relationship banking attractive for the case banks in corporate banking. These historic bank understandings or learnt priors about these micro factors were perceived as key causal factors for relationship banking.

6.3.1 Efficient risk management

The majority of the interviewees emphasized the importance of risk management in corporate banking. Banking products involve risk. The case banks took risks and got paid for it. For example, a relationship manager in the UK based multinational bank S claimed.

> "Banking is really about risk and reward. You measure risk and your reward should match. If you take a high risk you should have a high reward. If you take a lower risk then your reward will be lower. That's the balance." UMSR

This quote demonstrates that the case bank made profit by taking risk. Profit was associated with managing risk. It was critical to find a good way to efficiently managing risk. The interviewees learnt that relationship banking was an efficient way to manage risk and make profit. As a director of corporate banking in the UK based multinational bank R stated.

> "I think the reason we look for a long-term deep relationships with clients is really based around the whole concept of understanding their business. We are not ever comfortable with the idea that you can lend money to your customers that you have never met. We want to understand what our customers are doing, we want to build the knowledge over time. Having a close relationship with our customers means we can anticipate and manage risk proactively." UMRD2

The above quote shows that knowing customers, understanding their business helped the case bank managers to make a decision on lending. Moreover the bank managers perceived that the close relationship with customers helped the case banks to evaluate the risk and price the product. As another director of corporate banking in UK based bank B conveyed.

> "By having a close relationship with our customers we know the customer, without a doubt. We are able to price the product absolutely right, and the customer gets the best in the market. We can anticipate the risk perfectly; we aim to predict the risk as well as we can such as bad debt in the future. These trust relationships really help to improve our risk profile and also increase our income." UMBD

This quote illustrates that by establishing long-term relationship with corporate customers, the case banks improved the risk profile and increased income from their lending portfolio. From these quotes one concludes that relationship banking was a good way that the case banks had chosen to manage banking risk. As a result the interviewees perceived that relationship banking was a successful strategy for corporate banking.

The literature also argues that the management of risk can be seen as the major activity of banks. Freixas and Rochet (1998) argue that banks have to control and select the risks inherent in the management of deposits, loans, portfolios of securities, and off-balance-sheet contracts. Banking risks are defined as adverse impacts on profitability of several distinct sources of uncertainty. From an operational viewpoint, there are four sources of risks affecting banks: credit risk, interest risk, liquidity risk and the risk of off-balance-sheet operations, which have been soaring during the last two decades.

The case bank interviewees emphasized credit risk in corporate banking although they mentioned other types of banking risks. For example, the Head of Marketing and Strategy of the UK based large bank B commented.

> "Risk is very important for banks. There are two elements. One is business risk and the other is credit risk. By knowing your customers and trying to understand your customers you can reduce credit risk. Because you are able to understand who they are, what their needs are, what their projects and final plans are, you can react to help customers to control the effects of credit risk. This is the credit side risk. The other is business risk. If your customers go to other financial service organisations, they will move their money away from you. What you lose is the value created by the customer." ULBD

The majority of interviewees perceived that establishing long-term relationships with corporate customers helped the case banks to reduce credit risk. As the above quote explains that by knowing the customers and understanding their businesses the case banks had information and knowledge about their projects and future plans and the processes. Therefore they had confidence on customers credit risks.

Bessis (2002) supports that credit risk is critical since the default of a small number of important customers can generate large losses, potentially leading to insolvency. Credit risk is risk that the customer may fail to repay the money that a bank is lending to a customer. Default risk, a major source of loss, is the risk that a customer default, meaning that they fail to comply with their obligations to service debt. In corporate banking a high percentage of banks assets are for small number of corporate customers therefore their creditability will influence the bank risk significantly. When the corporate customer demands a large amount of funds several banks would share the risk and provide a syndicate loan.

The case bank interviewees perceived that managing banking risk was more difficult than before. The corporate customers' businesses were more and more complex and the financial products and services they used were more and more complicated. Technological progress and deregulation have both provided new opportunities for and increased competitive pressures among banks. In the late 1980s, margins attained from traditional banking business began to diminish. Banks have expanded to new products and more services. Traditional banking practice, based on the receipt of deposits and the granting of loans, is today only one part of a typical bank's business. New financial products and services, such as swaps and hedging

transactions, and underwriting securities, generate more income but increase risks for the bank. Therefore it was essential for the case banks to find the appropriate ways to managing banks risks. The interviewees perceived that relationship banking reduced credit risk. For example a director of corporate banking in the UK based multinational bank H remarked.

> "It is certain we can reduce our risk by knowing our customers and by understanding their business. Relationship banking is really an ongoing process of minimizing risk and maximizing profitability". UMHD

Furthermore the interviewees explained how relationship banking reduced credit risk. For instance the general manager of business financial service in an Ireland based large bank N claimed.

> "The more you know the customer, the more you can reduce risk because the biggest risk is because of lack of knowledge. Lack of information is going to put your business at risk. The more you know the customer, the better the firm you are, and therefore your business will be better." ILNG

The interviewees identified the central relationship between customer knowledge and credit risk. The case banks reduced credit risk by accumulating customer information over time.

Some theories also explain risk management from the existence of asymmetric information (Stiglitz and Weiss, 1981) and the hypothesis of multi-period contracts. A potential borrower may possess more information than the banks on the probability of success of a project. The banks may encounter adverse selection and moral hazard problems. Based on multi-period credit contracts, the borrowers have an incentive to repay the debt. The development of a long-term relationship between the bank and the firm may allow the bank to build up a credit history for the firm. This information advantage may allow the bank to provide financing at the appropriate time and thus reduce adverse selection. This long-term relationship reduces the possibility of the firm to default the debt in order to receive financing during the life cycle of the firm. Some companies that define a commercial bank as their main financial partner have

been receiving financing from the same bank for more than 9 years (Berger and Udell, 1998).

Moreover the case bank interviewees believed that maintaining close relationships with customers helped the case banks to monitor customers. The case banks could find and react to those problems immediately. For instance the Managing Director of Corporate and Commercial Banking in the UK based large bank A stated.

> "Maintaining close relationships with corporate customers ensures that ongoing credit processes and information requirements are met. Relationship managers collect customer information over time and develop an in-depth understanding of their businesses. They monitor, analyze, interpret and summarize customer information in order to assess customer credit risk." ULAD

Diamond (1984) argues that the monitoring function tends to eliminate the problems of moral hazard deriving from conflict of interest. Aoki (1994) identifies three monitoring actions that banks take to reduce information asymmetries between banks and customers. Ex ante monitoring consists of credit evaluation and screening to reduce adverse selection. Interim monitoring refers to the lender observing and controlling the actions of the borrower after it makes the loan but before the borrower repays it. Ex post monitoring includes verification of the borrower's financial results, penalizing poor results and renegotiating in case of temporary events outside the borrower's control that do not harm its long-run prospects. The banks may renegotiate with firms when the borrowers enter financial distress because of short-term liquidity problems if they have longer-lasting relationships with their borrowers (Chemmanur and Fulgheri, 1994).

Sheard (1994) argues that relationship banks have lower lending risks than do transactional banks. First, relationship banks have better information than outside claimants about why a firm became distressed, what its prospects are, and how best to resolve the distress. Second, relationship banks have clearer incentives to monitor the borrowers. Third, relationship banks may exercise influence over distressed firms. As a result, relationship banks participate actively in resolving financial distress whereas transactional banks participate passively. Bornheim and Herbeck (1998) illustrate that

the gross marginal benefits from the relationship are shown to be a negative function of time, to costs, which are instead increasing with the length of the relationship. Marginal gross benefits are mainly due to the reduction of capital costs in response to the private information about borrower quality provided by the relationship. As a consequence the price of the loans falls (Petersen and Rajan, 1994), loan size rises over time and collateral demand also tend to decrease (Boot and Thakor, 1994).

Finally, the case bank interviewees believed that good relationship banking involved the judicious taking of risks, managing and pricing them properly, rather than avoiding or hiding them. The case banks will inevitably encounter risks, a loan may turn bad, a holding of debt securities may depreciate in value because of an interest rate hike, and a long position in foreign exchange may involve book losses when the domestic currency strengthens. Therefore the case banks needed customer information to screen borrowers and to monitor the projects. For example a relationship manager in the UK based multinational bank S remarked.

> "It is inevitable that you incur bad debt if you are in the lending market. If you do not incur bad debt, you are not doing your job properly because you are closing out opportunities. Relationship banking is expected to be less risky to lend to someone you have known for 20 years than someone who just comes straight in with a new idea." UMSR

The above quote illustrates that relationship could be employed to reduce credit risk. But the final objective of relationship banking was making profit. Therefore relationship banking was seen as a good way to manage risk efficiently rather than take less risk. For example, a senior relationship manager in the UK based multinational bank L stated that.

> "You have got to be very aware of risk but it is a balance. If you did not take any risks you would not make money. What you have to make sure is that you have been paid for the risk. Understanding the companies' business, understanding where you are in the risk. Your risk profile, is it a low risk, medium risk or high risk? I think we need to have a balanced portfolio. If we take too much risk when it goes wrong our performance and revenue will come down. If someone does not know the company they may think they are high risk and lose the business but if you know the company

> you will say no they are not a high risk. If you gain knowledge about the company and more information from them, so you will not think it is a high risk any more."
> UMLS

This quote explains the role of relationship banking for managing risk in corporate banking. Having long-term relationship with corporate customers the case banks could know the customers' businesses, understand their risks, price the risk properly, monitor the on-going project, and make profit.

In general, the case banks learnt that relationship banking was efficient for managing risk in corporate banking. The case banks believed that it was critical to manage risk particularly credit risk in corporate banking. Under increased competitive pressure the case banks chose relationship banking as a way to manage their risk. By knowing the customers over time the case banks could understand the customers credit risks, make right decisions at appropriate prices. By maintaining close relationships with them, the case banks could monitor their on-going projects and take a reaction in time. Therefore the interviewees perceived that they could have an optimal risk portfolio and make a good profit.

6.3.2 Effective for managing cost

All of the case bank interviewees argued that it was more cost effective to keep an existing customer than acquire a new customer. For instance, a director of corporate banking in the UK based multinational bank S commented.

> "I think relationships add value very much on the basis of customer retention because it is much cheaper to keep a customer than get new customers. We do not have to spend the same degree of time, effort and market expense and legal cost."
> UMSD2

Moreover it was easier to keep a customer and do business with existing customer because there was a switch cost for the customers. As long as the corporate customer was happy with their service they would not leave. Customer turnover was normally

high among new customers, those who have dealt with a firm less than one year. For instance a senior relationship manager in the UK base multinational bank L said that.

> "They do not want to leave because no one wants to leave the bank because it is hassle --- you know it causes problems. You have to change to new chequebooks. As long as they are happy, they should not want to leave. My role is to make our customer happy so they do not leave to go to another bank." UMLS

The case bank interviewees perceived keeping existing customers was easier and cost effective. The average cost of a customer would decrease overtime as the case banks spent a big amount of money to earn the customer. A relationship manager in the UK based multinational bank S explains:

> "Maintaining a customer relationship is more cost effective. The reason is that the cost involved decreases over time. For example, a customer simply opens an account. The cost of opening that account might be equivalent to what you may earn from the account for the next three years. A new customer of the bank is more like new business for the bank; the bank will make a lot of money from the account over a further three years. Beyond that, the bank will start to make a return from that account." UMSR

The above quote indicates there was an acquiring cost at the beginning of the relationship. Most advertising and much of sales and marketing expenditures were directed toward customer acquisitions. Then there were application costs, setting up new accounts, and credit checks. The average cost of this relationship decreased over time because the maintaining cost was much less than acquiring cost. As the relationship with a customer developed, there was greater mutual understanding and collaboration, which produced efficiencies that lower operating costs. The relationship managers paid more attention to the customer and listened better to what the customer says. Then they used the customer as the key driver for continuous process improvement. Very detailed, actionable data was gathered directly from the customer and fed to the processes.

Moreover, the interviewees perceived that the average cost of a customer would decrease if the customer used more financial products and services. For example, the Head of Marketing and Strategy of the UK based large bank B claimed.

> "Customers will probably place reliance more on the services they get from the financial services organization rather than just an individual product. For example a financial service company provides a direct loan to the customer. The direct loan may attract interest on savings and discount interest on lending. That's great if you are able to attract the customer once and you have an ability to cross-sell other products. It is likely you would be successful." ULBD

This quote explains that the average cost of a customer decreased as the customer used more products and services. Because some products cost very much such savings and others cost much less such as transferring money between accounts.

The case bank interviewees argued that satisfied customers were more likely to refer to others, which promoted profit generation because the costs of acquisition of these new customers were dramatically reduced. For instance a relationship manager in the UK based multinational bank S remarked.

> "Another major issue is that a good long-term relationship with a corporate client usually means you have a good advocate from that in the market place. Our customers are a fairly vocal support particular in their high profile entrepreneur community. They will tell their colleagues and friends they get a good service, a good responsive service from their bank. It is a much better way to get new clients. This is the main way in which we increase our customer base, by word of mouth, by our good customers telling their friends and associates that they have a good experience with the bank." UMSR

The above quote explains that the satisfied customers introduced their friends, business partners to the case banks. Advertisement was expensive and not effective for acquiring new customer in corporate banking. It was a good way to get new clients by having a good advocacy in the entrepreneur community. Moreover the large corporations were visible in the market place and the banks they use were visible to the lower level of economies. So the smaller businesses or the individuals

will choose the bank as well as. They believe that there must be good services, good products, or good delivery for the multinational to use.

Furthermore the cost effectiveness, the comparison of gains and cost, can be improved by increasing incomes. As customers become more satisfied and confident in their relationship with the bank, they are more likely to give the bank a larger proportion of their business, or 'share of wallet'. For instance, a senior relationship manager in the UK based multinational bank L conveyed.

> "Because banking is purely about relationships, the longer you have a relationship with a customer at any level, the easier it should be to increase sales to that customer. We also look into their share of the wallet." UMLS

This quote mentions that the customer share of wallet at the case banks increased over time. One of the reasons that the case banks chose relationship banking was the up-selling opportunity, which will be discussed in nest theme. The average cost reduced when the case bank got more business from the corporation.

Some literature also mentioned the cost effectiveness of keeping customer relationships. Research has shown that the costs of acquiring new customers are somewhere between 5 and 10 times greater than the costs of keeping existing customers (Flanagan and Safdie, 1998). Reichheld and Sasser (1990) find the financial impact of customer retention. They found even a small increase in customer retention produced a dramatic and positive effect on profitability: a five percentage points increase in customer retention yielded a very high improvement in profitability in net present value (NPV) terms. Increasing the customer retention rate from, say, 85% to 90% represented a net present value profit increase from 35 per cent to 95 per cent among the businesses they examined.

In general, the case bank interviewees perceived that relationship banking was effective for managing cost. The average cost of a customer decreased when the case bank maintained it longer, up-sold or cross-sold more to the customer. Therefore the case banks focused more on customer retention and ensuring the appropriate amounts of time, money and managerial resources were directed at this task.

6.3.3 Necessary for cross-selling

The majority of interviewees argued that maintaining the customer relationship gave the case banks good opportunities to cross-sell other financial products and services. For example a relationship manager in the UK based multinational bank S stated.

> "Banking is not just making loans, but also delivering more value from cross-selling more products to the same customer. And you can see across the whole of the market, banks traditionally may be seen as lending banks, but now they are diversifying to related financial activities. The reason why banks try to establish long-term relationships is because of the nature of profitability; the customer relationship links to a number of products and services." UMSR

This quote demonstrates that the case bank diversified into related financial activities and the customer relationships linked to a number of products and services. The previous themes discussed macro conditions (see chapter 5) in the corporate banking market including advances in technology, financial deregulation, and business globalization facilitated an expansion of the product and service range of the case banks. The case banks could meet the customer needs by developing a wide range of products meanwhile the case banks could get more income by cross-selling more products to the same customers if they could maintain their customer relationships. The chief executive of corporate banking in the UK based large bank K explained the cross-selling procedure in detail according to his long time experience in corporate banking.

> "You start a relationship by taking the deposit from the company. Then you handle the import and export facilities and credit documentary bills, foreign exchange, and you can handle some leasing requirements, and you can handle some debt financing, receivable financing. Hopefully you will get the chance to provide personal banking services to the executives of the company, and you can handle their payroll, so you get the chance to pay their employees, that gives you an opportunity to open an account for them as well. So when relationships mature, there are many opportunities to increase the value of the relationship." ULKC

This quote illustrates that most customer relationships began with a saving product or lending product. Gradually the case banks provided more ancillary products or services to the companies. When the relationship developed the case banks offered some more related financial products and services such as cash management and insurance. Some case banks especially those large multinational banks provided security underwriting and financial derivatives. These activities fulfilled the customer needs and the banks received more incomes. These non-core financial products and services were difficult to provide to a new customer. Some case banks developed some so called relationship products exclusively offered to those customers with long-term relationship with the case bank. These activities in turn deepened the relationship further.

The case banks recognized the value to be captured from the effective cross selling and evolved into multi-product groups. "The strategy of pushing new products to current customers based on their past purchases, cross-selling is designed to widen the customer's reliance on the company and decrease the likelihood of the customer switching to a competitor" (investorwords.com)[16]. These customers generate a large amount of interest and fee income for the banks thus they affect the bank performance tremendously. For instance the director of corporate banking in the UK based multinational bank R remarketed.

> "We look at how profitable a company is. If it is not profitable, we won't take it on. We feel we can make money and looking forward, we can cross-sell other products. They may have some loans, but we would like to sell them treasury products, credit cards, increase the number of sells. So we can make money. We are here to make money for shareholders. Shareholder value creation is closely linked to customer value creation. Shareholder value can only be created by attracting and retaining customers and winning a greater share of their financial services business." UMRD1

This quote indicates that the case bank evaluated the customer profitability by integrating the whole range of products and services the customer engaged with the case bank. By integrating information from all of these points, the case banks could get a full picture of customers. This integrates information database. The case banks

[16] The biggest, best investing glossary on the web.

may have an information and knowledge advantage, which will be discussed in the chapter 8. Interestingly, the interviewee mentioned the relationship between shareholder value creation and customer value creation. By keeping customer longer, winning a greater share of wallet, cross-selling more products, the case banks could make more profit and therefore created more value for shareholders.

The interviewees perceived that the case banks explored cross-selling opportunities through relationship banking thus decreasing the average cost and increasing income. Economies of scope exists when a number of services can be produced jointly more economically than producing them separately. For example a director of commercial banking in the UK based large bank A commented.

> "... that's bright, you are able to attract the customers once ... and to cross-sell other products to customers. Obviously you need a chance to generate more business. By establishing such a relationship we have opportunities to promote and meet customers' needs. It will result in additional product sales and income from the connections. It is just good economics." ULAD

The above quote argues that cross-selling was a good economic idea. By establishing long-term relationship with customers, the case banks had opportunities to cross-sell additional products. There was an economy of scope, competitive benefits to be gained by selling a broader rather than narrower range of products. There were two sorts of economies of scope, cost economies of scope and revenue economies of scope. Cost economies of scope gained through the sharing of IT platforms and other overheads, information and monitoring costs, and the like. Revenue economies of scope gained from the increased income by cross-selling more products. Strong cross-selling potential existed for major corporate clients including banking, insurance and asset management products, trade-finance, mergers and acquisitions advisory services, and so on.

Some literatures discuss the economies of scope. For example, Stefanadis (2002) argues that economies of scope exist because information can be reused and thereby avoid cost duplication, facilitate creativity in developing solutions to client problems, and leverage client-specific knowledge. The situation arises when the cost of

performing multiple business functions simultaneously proves more efficient than performing each business function independently (investorwords.com)*. According to *Money* magazine, it costs a bank five times less to cross-sell to an existing client than to acquire a new one.

However, in contrast to the interviewees' opinion, some other researches find that cost-diseconomies of scope may arise from serious cultural differences across the organization and erode product quality in meeting client needs. Most empirical studies have failed to find cost-economies of scope in the banking, insurance or securities industries, and most of them have concluded that some diseconomies of scope are encountered when firms in the financial services sector add new product-ranges to their portfolios. Saunders and Walter (1994) investigate the world's 200 largest banks and find as the product range widens, unit costs seem to go up.

Nevertheless, these studies covered the period of shifting away from a pure focus on banking or insurance, the institutions may thus have incurred considerable costs in expanding the range of their activities. They may achieve future benefits of expansion of market-share or increases in fee-based areas of activity.

In addition, some other researches argue that revenue-diseconomies of scope could arise from management complexities and conflicts associated with greater breadth. For example, the multi-product financial firm acts against the interests of the client in the sale of one service in order to facilitate the sale of another. Kroszner and Rajan (1994) found that U.S. bank affiliates typically underwrote better performing securities than specialized investment banks during the 1920s, when US commercial banks were permitted to have securities affiliates. Puri (1999) found that securities underwritten by commercial banks generated higher prices than similar securities underwritten by investment banks.

The interviewees perceived that the customer was less likely to leave if the customer used more products from the case bank. Relationship banking facilitated the case banks to cross-sell more products in turn cross-selling helped the case banks to maintain customer relationships. For example, the Managing Director of Corporate

and Commercial Banking business in the UK based multinational bank R commented.

> "We also think about the scope of relationship banking because if our customers trust our relationship managers more generally, it is easier to sell them products. They have to spend time meeting the customers and understanding the customers. Many customers want to have a relationship with us, because they think we have many products and are in a position to add value for them. Therefore people want to have a relationship with us." UMRD2

This quote and others like it shows that cross selling improved the banks' ability to attract or retain customers on the basis of offering a broad range of financial products. The case banks provided more products and learnt more about their business. The customers trust the relationship manager and knew that the case bank could fulfil their needs.

MacroMonitor[17] data shows that consumers prefer one-stop shopping. The studies based on survey data show that companies view banking products and services as a single value-chain, so that those banks who are willing to provide significant lending are also more likely to obtain M&A advisory work (Walter, 2002). Even absent economies of scope, risk aversion or informational synergies the benefit of cross-selling results from the contracting opportunities (Cabral and Santos, 2001).

In general, maintaining customer relationships gave the case banks good opportunities to cross-sell other financial products and services. The case banks explored cross-selling opportunities through relationship banking thus decreased the average cost and increased income. There were two sorts of economies of scope, cost economies of scope and revenue economies of scope. Relationship banking facilitated the case banks to cross-sell more products. It also helped the case banks to maintain customer relationships.

[17] The MacroMonitor is the largest comprehensive financial services database.

6.4 The intervening conditions of relationship banking

The intervening conditions included customer needs, customer confidence and the importance of trust in banking business. These were the structural conditions bearing on action/interaction relationship banking strategies that pertain to the phenomenon. They facilitated the strategies taken within a specific context, and altered the impact of causal conditions on the phenomenon. The interviewees perceived that these contextual factors of need, confidence and trust influenced the case banks actions/interactions in relationship banking and were in turn influenced by the conduct of relationship banking.

6.4.1 Customer information and knowledge

All of the case bank interviewees realised that customer information and knowledge was essential in corporate banking. The case banks established long-term relationships with corporate customers to obtain information and knowledge. For instance, a corporate banking director in the UK based multinational bank R conveyed that.

> "I think the reason we look for long-term deep relationships with corporate clients, is really around the whole concept of understanding their business. When you have hundreds of, millions of, in some cases billions of pounds, to lend to your customers, you need to understand their businesses. We want to understand what our customers are doing, and want to build that knowledge over time. So we are very happy to build the relationships with customers at all levels. What relationship is all about is understanding the clients." UMRD2

> "I think relationship banking is all about listening to our customers. We are listening to the customer and you tell me something about your company and what you want and we sell what you want. I think that relationship banking is about understanding the customers' business, and then being able to add value by giving them good services and products." UMLS

> "... You establish long-term relationships with your customers, and you have got opportunities to talk with your customers. You get the opportunity to continue to talk to your customers over an extended period of time. We truly understand what their financial needs are. By establishing such a relationship we have the opportunity to

identify how we can serve these customers, provide them with a variety of products and services from us over a longer lifetime." IMIH

The above quotes demonstrate that the case banks needed customer information and knowledge to do businesses with their corporate clients. The long-term customer relationships assisted the case banks to acquire customer information and knowledge by listening to or talking with corporate customer overtime. These quotes also covered some contents about customer information such as what they are doing and what they want.

Moreover, the case bank interviewees mentioned some private information such as customers' future plans. This information was not available in public and sometimes sensitive. Establishing long-term relationships with corporate customers was a good way to obtain private information. For example, a corporate banking director in the UK based multinational bank R indicated that.

"Establishing long-term relationships with corporate clients, the relationship managers can share information about customers' future business, confidential information. When confidence is built up customers are happy to do that. This is a strong element you can trust. Over a period of time they both understand each other and trust each other and the transactions come along. Some people actually talk about their business very much but some others only tell you what they think you need to know and not tell you everything about their business. I think you have to get yourself in a position with them and they will be more likely to want to share information with you and get opinions from you." UMRD1

"We have relationships with our customers. It just means open and honest. The customer will open to us. Our customers are very honest in telling us what they are doing and what they are trading. Our customers will tell us their problems, their concerns. For most customers we will get each year an indication of what they want to do for the next five or twelve months, any more than that would not be worth it. Nobody knows what will happen in two or three years. But for the next twelve months they will tell us what they are doing, give us cash flow and explain where they are going." UMRD2

Furthermore, the interviewees explained how the case banks employed this public and private information in corporate banking. First, the case banks accumulated

customer knowledge that assisted the relationship managers to understand customers' business and make decisions on transactions. Second, the case banks utilized customer information and knowledge to specify customer needs and sometimes predict their future needs. Third, the case banks used customer information and knowledge to choose and even innovate financial products and services. Finally, customer information and knowledge facilitated the case banks to run an efficient internal management, which will be discussed in detail in Chapter 7. The following quotes demonstrate these points.

> "What we do is that we try to develop long-term relationships. We get information and over time we build customer knowledge. We understand our customers' business and their industry and their market in more details. Something like that won't happen in a night." UMBD

> "Relationship banking is about knowing customers well. You know what are the company needs, what financial products and services will the company spend on. How much money can I make from those areas of service? Relationship banking is about matching the needs of corporate customers. If they want something such as they want to sort out vehicle finance, you do the deal with vehicle finance." UMHR

> "We believe one key way is listening to you and trying to understand your needs better. This enables us to provide financial products and services that you really want, rather than just what we think you want. We develop tailored products and services to meet customer needs."ULND

> "By establishing close relationships we may get to know customers well and understand their business, and can see what we can do for their business. We have opportunities to promote our products and meet customers' needs, which will result in good relationship management." ULAD

In the literature, relationship banking is most directly aimed at resolving problems of asymmetric information (Boot, 2000). With relationship banking, a borrower might be inclined to reveal more information and the lender might have stronger incentives to invest in producing information. Relationship banking facilitates a continuous flow of information between the borrower and the lender and gives access to "private" information, that tends to remain confidential (Berger and Undell, 2002). Lenders may rely more heavily on their personal relationships with borrowers because this

information is not readily available from financial statements and more appropriate in some circumstances (Elyasiani and Goldberg, 2004). On the whole, information asymmetries are overcame more effectively with relationship banking.

Nevertheless, there is little known how does relationship banking exploit customer information in the literature. This study discussed the process in detail. The access of public and confidential customer information was linked to a competitive advantage of the case banks in comparison to other financial intermediaries. However, the existing work falls short that it does not identify the precise benefits from this information and knowledge advantage. This dissertation will discuss the benefits for both the case banks and their corporate customers in Chapter 8.

6.4.2 Customer needs

The interviewees perceived that the long-term relationships between the case banks and corporate customers could be built only when both sides expected to do it. The corporate customers were willing to have long-term relationships with the case banks because of the continuity of their financial needs. As the director of corporate banking in the UK based multinational bank Ba says.

> "The relationship management model, really the reason for that is, because we know the customers are looking for long-term value from us. Compared with other businesses. For example, I go out in the morning and buy a newspaper. I just transact all the value at the time. I make the purchase so I do not need a relationship. For the retail seller such as supermarkets they do not need to build relationships because the value had passed at the point of deal. For corporate banking, our customers want to gain value over the long-term. If they establish long-term relationships with the bank they will gain the value over the lifetime of the relationship." UMBD

This quote demonstrates that the corporate customers wanted to establish long-term relationships because of the character of banking services. They used some banking products such as saving, cash management all the time. These were continuous business not one time transaction. The corporate customers enjoyed of good quality

service on the basis of long-term relationships. Therefore the customers were willing to have a long-term relationship with the case bank.

Moreover a long-term relationship was desirable under current situation in the corporate banking market. The financial markets were more volatile than before. It was essential to find a stable financial service provider in the uncertain market. Establishing long-term relationships with the case banks was a good way to secure their financial service providers. For example, a director of corporate banking in the UK based multinational bank H claimed.

> "Sometimes the market changes. Sometimes interest rate changes. The company wants to develop a relationship through a long period of time. The corporate customers build a relationship with the bank which is going to support them. The decision-making process with the corporate customer has to take time to trust both the bank as a brand and the individual relationship manager." UMHD

The above quote illustrates that the market was uncertain. The corporate customer wanted to have stable long-term relationship bank to support them. Furthermore as the above quote mentioned that corporate customers took long time to find a brand and individual relationship manager that they could trust. Therefore they wanted this relationship to last as long as possible. For example a senior relationship manager in the UK based multinational bank L remarked.

> "Banking is very competitive. Another bank will say leave bank L and come to our bank. The customer will say no. They've got a relationship manager and very good services from bank L therefore they do not want to leave. It is important to build relationships over a long time and get a particular service and competitive package. If the company wants to leave the bank, it is a hassle and causes problems. They have to change to new chequebooks. As long as they are happy, they should not want to leave. My role is to make our customers happy so they do not leave to go to another bank." UMLS

The above quote mentions that corporate customers would like to stay with the banks for long time. When the company built a relationship with the bank, they would have a lot of problems if they left the bank and switched to another bank. Leaving a bank

incurred a lot of work to do such as paying all the outstanding debts; forgoing all the benefits they achieved. Establishing a new relationship cost the customer more time and resources.

Moreover when the corporate customers wanted to borrow some money from the bank, they needed to be credit worthy. A high rank of credit was very important and could be built only through a long time credit history. Customers treated this credit as a valuable asset and would not destroy it by leaving the bank. For example a relationship manager of a UK based large bank R commented.

> "If you want someone to take a risk by lending you and monitoring your business, they need to understand your business. The trust, you can only build upon a long-term relationship." UMRR

Some literatures support these statements. Dewatripont and Maskin (1995) find the importance of long-term relationships for firms that they prefer bank to investor financing. Corporations increasingly tend to concentrate their banking activities among fewer banks (Moriarty and Kimball, 1983). Those banks having long-term relationship with the customer were more favorable.

In addition the interviewees perceived that the relationship corporate customers tended to do more complicated transactions and required more and more complicated products and services. These characteristics made customers find the case banks, which could understand their business and fulfill their requirements. The case banks spent more time to understand these customers' business and requirements therefore the corporate customers wanted to establish long-term relationship with them. For example, a relationship manager of the UK based large bank A said.

> "For the big corporate customer we need much more time because it is much more complex. The corporate customers tend to do more complicated transactions and need more complicated products and services. We need a deep understanding and have the capability to deliver complicated and sometimes more expensive solutions to large corporate customers." ULAD

The above quote shows that corporate customers' needs were more complex. They wanted the case banks to understand their business and deliver tailored, complicated solutions. These requirements could be met in relationship banking. Therefore the corporate customers wanted to build long-term relationships with the case banks.

Moreover, every company was unique. They might have different requirements and need particular solutions to resolve their problems. For example, a director of business banking in a UK based large bank Nw commented.

> "Every company is unique - with its own challenges and opportunities. We recognize that it is important that customers are able to work with an experienced manager who can focus precisely on their requirements, and provide them with the exact level of support." ULND

The corporate customers knew that only the particular managers in the particular banks understood their business and had capability to provide the exact support. Therefore it was important to have these banks as their relationship banks and these managers as their relationship managers. The corporate customer always complained when their relationship manager changed.

Furthermore the interviewees perceived that the customer needs were changing all the time thus it was more difficult to anticipate the customer needs and quickly respond to their changing needs. Therefore establishing a long-term relationship allowed the case banks to identify the customers' changing needs and match with their full range of financial products and services. For instance, a director of corporate banking in the US based multinational bank Ci stated.

> "The markets are evolving and customer needs are changing. By continuing to listen to our customers, and developing and providing products and services to meet their needs, we build durable relationships with our customers by fulfilling customers' needs. We constantly seek to better serve our customers." SMCC

The interviewees argued that corporate customers were more concerned about the availability of funds and the flexibility of products and services more than the prices.

Price was important but they would pay a high price for a suitable product and quickly delivered financial service. For example a relationship manager in the UK based multinational bank S conveyed.

> "If your customers feel they are gaining flexibility, if they feel that you have the capability to meet their current or future financial needs, you will be able to get the business and command a better price. Price is less important than that in the competing situation." UMSR

Some other researches support the statements. The Capital Markets Company' survey (Figure 6-1) illustrates that customers were expecting more from banks in terms of customized products and personalized services throughout a long period of time.

Figure 6-1

Customer retention factors	Degree of importance
Grouping products around life events	24%
Product breadth and depth	41%
Research and information	24%
Customized and personalized products	76%

Resource: The Capital Markets Company 2002

In general, the case banks perceived that corporate customers would like to establish long-term relationships with the case banks because of the continuity of their financial products and services needs. They wanted to make sure that they could get suitable products and quick delivery to meet their specific needs overtime in the volatile corporate banking market. They would like contact with a banker who is familiar with their business and has more knowledge of their situation. This would avoid explaining the situation once again and providing more documents hence getting quick response. Without the expectation of corporate customers it was impossible to establish long-term relationships with them.

6.4.3 Customer confidence

The interviewees believed that the corporate customers were willing to have long-term relationships with the case banks for financial products and services. Relationship banking gave customer confidence to deal with financial transaction.

First of all, having long-term relationships with the case banks the corporate customers could get financial products and services easier because they have built trust, which was very important in corporate banking. For example, when the companies wanted to get loan from the case banks, they must be credit worthy, which could only be built over a long period of time. As the chief executive of the UK based large bank K commented.

> "Trust is very important. I do not think it is more complicated than that. It takes quite a long period of time to build trust. They (the customer) feel comfortable explaining why they taking on the project, for the future what their strategy is, which enables us to provide a suitable product and help them to achieve their ambition." ULKC

This quote illustrates that the corporate customers would tell the case banks very important information because they trust the case banks. This enabled the case banks to provide suitable products and services. With mutual trust the case banks could exchange information with their corporate customers. Some time the case banks were able to get some confidential information such as the customers' future plans. This would give the case banks information advantages in corporate banking market. Over a period of time the case banks could understand the corporate customers' business and get knowledge advantages. The case banks could explore information and knowledge advantages in corporate banking market. For instance a director of business banking in an Ireland based large bank No remarked.

> "The company has a relationship with the relationship manager. They share information about their future business, confidential information. This is a strong element that they can trust each other. Over a period of time they both understand their businesses and react to their businesses. I guess that is the meaning of long-term relationships in business banking. When confidence builds up, customers are happy and the transactions come along." ILNG

The above quote explains that the corporate customers got confidence when they built trust over time. Morgan and Hunt (1994, p. 23) define trust as the "confidence in an exchange partner's reliability and integrity".

Moreover, the interviewees mentioned that the corporate customers expected to establish long-term relationships with the case banks because they wanted to make sure that when they had problems the relationship banks would help them. No banks or financial institutions would help a company in difficult times if it changed banks too often and was always looking for best prices. For example, a director of corporate banking in the UK based multinational bank B remarked.

> "Over a period of time, 30 years or 20 years, all the companies will have good times and bad times. Relationship banking means we should support them through difficult times, not just make money at anytime." UMBD

The above statement indicates that every company had bad times in financial management. The case banks would help their customers if the customers had a temporary financial difficulty, because the case banks treated the customer relationship on the basis of a long-term period of time. If they helped the customers going through the temporary difficulty the relationship value could improve. For example, a director of corporate banking in the UK based multinational bank S conveyed.

> "If companies have difficulties, we have choice, we can call off or reconstruct the structure of the financing. If we call off we will lose a lot of money. Or we can restructure. We will do a debt equity swap, put in new management. So we can hopefully provide support and get the best return for the bank. And in the end we save their jobs possibly create them money. But the big problem at the moment is that difficulty. We prefer to restructure rather than go for insolvency." UMSD1

The above quote demonstrates that the case banks preferred to help the customers when they had financial difficulties. If the customer went bankrupt the case banks could lose a lot of money that they had put into the company. If the case banks

provided support, the company went through the tough time and the case banks recovered the debt even gained better return.

Furthermore, the actions that the case banks adopted depended on the strength of the relationships. A long-term relationship could help them to pass through the bad times. For instance, a relationship manager in the UK based multinational bank R expressed.

> "When they get into difficulties we will try to work together to resolve any issues because doing that is much better than any other action you may take. If you have a less strong relationship you might be trying to take a banking approach to a difficult situation. We need to proceed to financial insolvency. But if we have a strong relationship we put some money and try to change the formula and work it through." UMSR

The above statement illustrates that if the case bank had a long-term relationship with the corporate customer. They would provide services or put more money to resolve the difficulties. Otherwise the case banks would precede financial insolvency. The case banks would like to help the customers with long-term relationships because they treated the relationships as a valuable asset and would not to forfeit it. Moreover, it was irrational to see a viable long-term partner suffering without helping. Lack of action could even deteriorate the situation. Furthermore, both the case banks and the corporate customers would have bad times; the case banks would get help when they got some difficulties. For example, a relationship manager in the UK based multinational bank Nt commented.

> "Developing long-term relationships is very important for both parties as they all have good and bad times in financial management. They do need help, especially during the bad times. Both parties work in the same manner." UMND

This quote indicates that both the case banks and their corporate customers were willing to establish long-term relationships to help each other during the bad times. If a company always switches their banks and searches for cheapest prices, nobody would help them when they have difficulties. Similarly, if a bank always seeks for highest profits from the transactions, the corporate customers may not help them even worsen the problems.

Some literatures also mentioned that close relationship with the bank can be seen as a set of implied and explicit promises to provide explicit or contractual promises to supply specific financial services or funding types dependent on certain events, and actual service or funding types at some point in the future (Holland, 1993).

If the corporate customers had long-term relationships with the banks, they were of confidence to deal with those financial difficulties. All organizations are increasingly exposed to risk and uncertainty from an ever-changing business environment. Uncertainty is the defining characteristic of the current business environment, and risk is its shadow. From financial market volatility to corporate governance scandals, geopolitical upheavals to regulatory change, firms face a formidable array of challenges.

Moreover recently the unexpected global events such as war against terror and raw oil price volatility lead to the financial problems of corporations. Therefore corporate customers need stable, secure lines of supply of credit, foreign exchange and other financial services and advice. The firms expect support from their relationship banks when times are difficult.

Holland (1993) argues that relationships are seen as an exchange of implicit insurance contracts in which the banks offer to insure the firm against a large set of the financial supply and financial price contingencies facing it.

In general, customer confidence was seen as an intervening condition in relationship banking in this dissertation. The corporate customers would like to establish long-term relationship with the case banks because they wanted to be confident of getting bank finance. Having a long-term close relationship with the case banks meant that the corporate customers would have some confidence when they had unexpected financial difficulties. Therefore the corporate customers expected to have a long-term relationship with the case banks. Without customer expectation the relationship banking strategy was unlikely to be successful.

6.5 Conclusion

In summary, this chapter discussed the causal conditions in relationship banking. The perceived causal macro-conditions influencing the adoption of relationship banking in the case banks included the advances in technology, financial deregulation and business globalisation.

These macro conditions had a significant effect on the banks. Greater competition diminished the cost advantage in acquiring funds and reduced profit margins. Customer relationship was seen as a source of competitive advantage. Establishing customer relationships reduced competition within the financial service industry and even made cooperation possible among financial institutions. Moreover, these macro conditions provided opportunities for the case bank. The case banks could effectively collect and process customer information and provide suitable products and services to meet customer needs.

However from the relationship manager's point of view some micro factors and intervening conditions made relationship banking more necessary in corporate banking. The case banks learnt over time that relationship banking was efficient for managing risk and effective for managing cost. In order to reduce credit risk, the case banks learnt that knowing customer and understanding their business over time were essential for making decisions. The interviewees perceived that keeping a customer was more cost effective than acquiring new customers. In order to cross-sell more products and services and gain more income it was necessary to maintain customer relationships.

Without customer expectation it was unlikely that the case banks could implement relationship banking strategies. Banking services that corporate customers needed were frequent and not occasional transactions. They wanted to establish relationships with the case banks, which could fulfil the customer needs in the future. Moreover, trust was very important for banking business, which was expected to be built on long-term relationships. Therefore they were of confidence to get good service in the

future. Furthermore, every company would have a bad time. Therefore they wanted to make sure the case bank would help them when they have financial difficulties.

In general, because of all the causal conditions and intervening conditions outlined above the case banks chose relationship banking as a good way to do business with corporate customers. The actions/interactions in relationship banking will be discussed in next chapter.

Chapter 7 The Actions/Interactions of Relationship Banking

The director of corporate banking in the UK based multinational bank H commented.

> "It is absolutely vital to have a meaningful relationship with them [corporate customers]. That's really why we do it [relationship banking] as a strategy we have chosen. We believe in the value of relationships and customer focus. The relationship means that we trust each other and have meaningful dialogue with the executives of that company." UMHD

A majority of the interviewees argued that they believed that the bank-corporate relationship was essential in corporate banking. Therefore the case banks adopted relationship banking as a business strategy and had trust-based communications between two parties. The above quote as an example highlighted the most important actions of relationship banking.

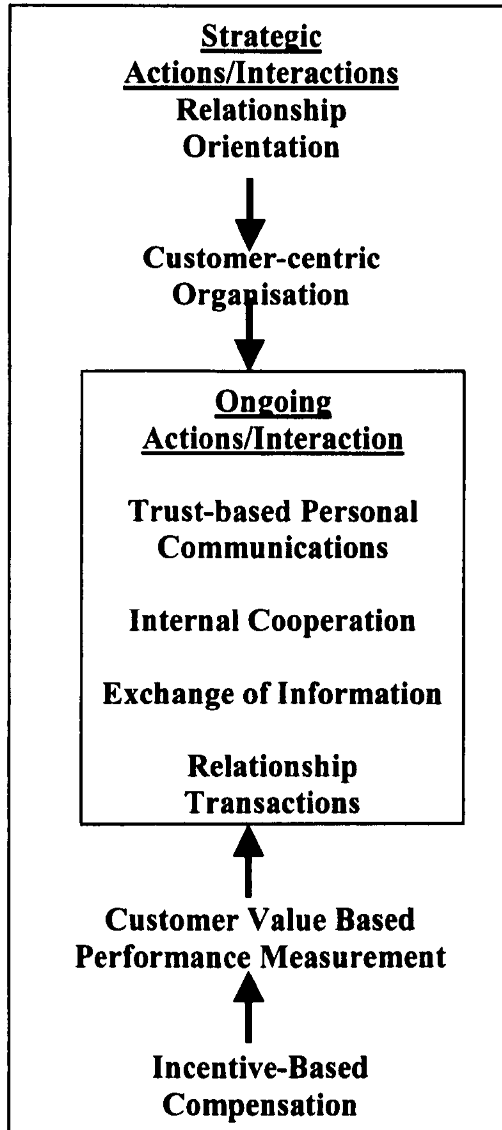
7.1 Introduction

The previous chapter described the conditions that the case banks established close and long-term relationships with their corporate customers. The macro-conditions including the advance in information technology, financial deregulation, and business globalization in the financial market, had a major influence on the case banks. The micro-conditions including risk management, cost efficiency and cross-selling were considered when the case banks chose their business strategy. The intervening conditions including customer needs and customer confidence had a significant impact on banking management. Under these conditions the case banks established long-term relationships with their customers and chose relationship banking as a good way to do business in corporate banking. The interviewees perceived that relationship banking reduced the case banks' competitive pressure in corporate banking market and facilitated the case banks to exploit business opportunities.

This chapter discusses the actions/interactions that the case banks adopted under these conditions. In this dissertation these actions/interactions of relationship banking were seen by the case banks as the means to reduce the information gap with customers

and reduces uncertainty in the corporate banking market and therefore allow lending and other financial service transactions to take place that would otherwise not occur, or not occur in "transaction" banking. The following sections use the case bank comments to show how the banks thought these actions /interactions of relationship banking allowed relationship banking to occur and transactions to be conducted. Figure 7.1 illustrates these action/interaction themes derived from the case data.

Figure 7-1 The actions/interactions in relationship banking



The strategic actions/interactions were relationship orientation, customer-centric organization, customer-value based performance measurement and incentive based compensation.

These strategic actions/interactions created the context for the ongoing relationship banking actions/interactions. The ongoing action/interactions were trust-based personal communications with customers, internal cooperation within the team and among divisions, exchange of information, and relationship transactions.

This chapter describes and explores the concept of bank-corporate relationship, which lies at the heart of relationship banking. A definition of relationship banking is developed in this chapter.

7.2 The strategic actions/interactions

Relationship banking was seen as a business strategy in the case banks. In order to implement this business strategy the case banks took actions and also conducted repeat interactions. These included establishing a relationship oriented corporate culture, organizing bank managers and other resources around the corporate customers, developing customer-value based performance measurement and incentive based compensation.

7.2.1 Relationship orientation

The interviewees argued that they believed in the value of relationships with corporate customers. Relationship orientation was a "cultural" choice in the case banks. They had a common belief and attitude toward customer relationships. The interviewees believed that the attitude of bank managers was essential because the managers' behaviours were determined by their beliefs. The beliefs and behaviour patterns comprise organizational culture. Organizations might have different cultural orientations, for example transaction-oriented versus relationship-oriented. The case banks had a relationship-oriented culture to deliver superior customer value. The relationship orientation included ways of thinking and behaving with respect to relationship formation.

A relationship-oriented culture meant that, the relationships between banks and corporate customers were treated as the fundamental asset in case banks. The following quotes and similar remarks from other case banks demonstrate that.

> "We can just do transactions. We can offer the lending facilities. We can underwrite bond issues. We can provide foreign exchange transactions. But we believe in the value of relationships and customer focus." UMRD2

> "We want to establish long-term relationships and keep long-term relationships with the customer. Relationships are key for our bank's survival and future development. We make them our priority because they are our long-term assets." UMSD1

> "It is very important to recognise that your customers are assets. If you've brought a company to the bank you've brought more value, not just the company itself. We look at the overall return from the relationship." UMHD

The literature explains the concept of corporate culture. Culture is the shared philosophies, ideologies, values, assumptions, beliefs, expectations, attitudes, and norms that knit a community together. All of these interrelated psychological qualities reveal a group's agreement, implicit or explicit, on how to approach decisions and problems (Kilmann, Saxton, and Serpa, 1986). Organizational culture refers to the unwritten, often unconscious message that fills in the gaps between what is formally decreed and what actually takes place. It involves shared philosophies, ideologies, values, beliefs, expectations, and norms (Deshpande and Parasuraman, 1986). These definitions reveal that culture is a complex concept that involves many factors. In this study, corporate culture is concerned with beliefs and values on the basis of which people interpret experiences and behave, individually and in groups.

Some researches also argue the right culture was a necessary condition for organizational success. Ouchi (1981) argues that corporate culture is key to organizational performance and that corporate culture could be managed to improve a company's competitive advantage. Slater's (1997) customer value-based theory of the firm argues that the superior performance accrued to firms that have a customer value-based organisational culture, complemented by being skilled at learning about

customers and their changing needs and at managing the innovation process, and that organise themselves around customer value delivery processes.

All of the interviewees in the case banks agreed that relationship banking was a strategic choice in corporate banking according with the character of the business. Relationship orientation meant that customer relationship was seen as a competitive advantage in the case banks.

> "We have nothing to compete on except establishing long-term relationships with customers." UMLS

> "Price is very important but we can not win business always on best price. The price depends on the variety of risks and the profit margin is very low now. Product innovation is important but a new product will become obsolete and our competitors can duplicate it. The customer's needs are ever changing. Therefore we want to establish close relationships with customers and keep them longer." UMHD

> "In terms of long-term business in corporate banking, such as making long-term loans, it is long-term banking activity. It will deliver a running yield year on year. It may not be profitable immediately, but it is for asset growth target, in terms of long-term business, over long-term banking activity." UMSR

These quotes demonstrate that the case banks might have some strategic choice to compete on including price and product. However it was difficult to have a competitive advantage on price because it depended on risk and the profit margin was very low in the competitive corporate banking market. It was also very hard to have a product advantage because the competitors were able to duplicate the new product soon. Moreover the customer needs were ever changing and therefore product innovation was hard to be used as a sustainable competitive advantage. Furthermore the long-term character of corporate banking activity made transactional banking strategy difficult in practice. Therefore relationship banking was chosen as a competitive strategy, a more customer-oriented approach, based on a culture of relationship.

Some other researchers also investigated the strategic choices of the banks in corporate banking. For example, Holland (1993) noted that relationship types between an individual firm and bank could vary in character over a range from "close" relationships to "transaction" relationships. Close relationships generally involve rich information flows, regular flows of low margin business and privileged access for the bank to big fee deals. In this dissertation when relationship managers talked about bank-corporate relationship, they refer to "close long-term relationship". Similarly Petersen and Rajan (1995) defines the firm-bank relationship as the "close and continued interaction" between a firm and a bank. Boot (2000) noted that some banks adopted transactional banking while some adopted relationship banking. Some banks were doing both transactional and relationship banking according to different products.

Strategy is the direction and scope of an organisation over the long-term: which achieves advantage for the organisation through its configuration of resources within a challenging environment, to meet the needs of markets and to fulfil stakeholder expectations (Johnson and Scholes, 2002). Thompson and Strickland (2001) argues that business strategy concerns the actions and the approaches crafted by management to produce successful performance in one specific line of business; the central business strategy issue is how to build a stronger long-term competitive position.

However, some other banks could still choose transactional banking as their business strategy based on the model of "poor relationship" characterized by undifferentiated lending polices, multi banking lending and a reduced demand for financial services other than credit. The other banks might have different understanding about the conditions or might have other skills to develop a competitive advantage. Interestingly, a couple of case banks did not think that they were good at relationship banking but they were making great effort to improve the capability of relationship banking.

7.2.2 Customer-centric organization

The interviewees perceived that the relationship orientation shaped the internal

structure of bank organizations. In the case banks customer relationships were seen as a resource of competitive advantage. In order to achieve this competitive advantage, the interviewees believed that it was necessary to organize the resources around customer relationships. Therefore human resource and other resources were allocated to build and maintain customer relationships. The organizational structure in the case banks was aligned to customer relationships rather than individual products and channels. The customer-centric organizational structure enabled the case banks to integrate customer information and understand customers better. This action facilitated the case banks to overcome barriers to transacting and allow lending or other financial services to occur. The following quotes and similar statements from the other case banks demonstrate that.

> "We divide our teams around customers. Within these teams the employees specialise in different products. This combines relationship managers and product specialists to develop financial solutions to meet individual client needs. Our aim is to add value through detailed industry knowledge." UMHD

> "I think the way to organise the employees is to make clear that they have the capability and they are focused on a particular group of customers. We segment our customers. In the corporate environment the relationship managers may give them a particular group of customers to look after. The relationship managers are responsible for regular contacts with customers and working with them on a frequent basis to understand their needs." ILNG

The above quotes indicate that the case banks segmented the corporate customers into some industry groups and organised the human resources and other resources around these customer groups. The teams were more customer specialised rather than product specialised. Therefore the teams accumulated industry knowledge over time. This organisational structure helped the case banks to understand their businesses, identify their needs and provide tailored financial solutions. Moreover the relationship managers were designed as the leaders of the teams and responsible for communicating with customers and in collaboration with team members.

Barney (1991) also argues that to fully realize the competitive advantage potential, a firm must also be organized to exploit its resources and capabilities. Customer

relationship is seen as a competitive resource (Woodruff, 1997). Therefore in order to take advantage of this competitive resource, the organisation needs to be structured around the customer.

The interviewees perceived that the corporate customers expected to resolve all their needs with a single point of contact. A primary source of competitive advantage was the opportunity to better satisfy current and new customer needs. Knowing customer's needs and expectations and satisfying them were essential for keeping customers. With a customer centric organisational structure, institutions could meet the customer needs and retain the relationships. The quotes below and similar statements illustrated that.

> "We are very customer focused. Every corporate customer benefits from a dedicated, professional and highly trained relationship manager. The relationship managers work with clients on a longer-term basis to identify their needs, then in collaboration with product specialists, to devise and successfully implement banking solutions to meet those needs." UMRD1

> "As a relationship manager, I will be your constant point of contact so you don't waste valuable time explaining your business each time you contact us. I really know your business and work with you to deliver the most appropriate funding decisions for you. I am quite confident in the organisation and backed up by a whole range of product specialists." UMHD

Some other academics also argue that an organization that is structured around customer segments is more likely to deliver a seamless view to the customer (Day and Bulte, 2002). Sweat (1999) describes customer centricity as being "about aligning a business to a customer's every need". A customer-centric concept emphasises understanding and satisfying the needs, wants and resources of the consumers. The increasing diversity in needs, wants, and resources of businesses make customer behaviour less predictable and forecasting less accurate. The adoption of a customer-centric organisational structure presented an opportunity to integrate activities around the customer.

7.2.3 Customer-value based performance measurement

It is said that what gets measured, gets managed (Gordon, 2003). Measures can drive behaviour. Performance measurement can be defined as the process of quantifying the efficiency and effectiveness of past actions (Neely, 1998). An appropriate performance measurement system creates links among long-term goals to the specific short-term tactics, measures and actions that drive performance (Metrus Group, 2003).

Performance measurement was perceived by the interviewees to be a critical component in the success of relationship banking. The case banks measured the performance of relationship banking in order to improve the effectiveness of relationship management. The following quotes and similar remarks from other case banks indicated that.

> "We believe that in banks, knowing the customer well, having a meaningful relationship with them, we will derive a greater and consistent level of income stream from customers over time. With our corporate relationships, there are always income streams. And we can always seek the opportunity to add value. So our belief is that over a period of time, having meaningful relationships with corporate clients enhances performance. It delivers value to our bank's performance. We need to measure it and make sure we have done it properly." UMRR

> "It is making sure that we set strategic targets at the beginning. For example, they should meet them [customers] four times a year. Our measuring system is also getting better about making sure we set proper targets. So it is making sure that the measurement] is ongoing. The relationship managers are expected to do so. There are formal quarterly appraisals. And at the end of the year, we have to go through the whole period." UMHD

> "The greater measurement is customer satisfaction in a number ways in bank N. We have an annual survey. We do uncover what's going on. We get feedback from customers. We get feedback from own business. If customers do not like what we are doing, they actually get words to say. So the customers will give us very useful feedback. They complain and we can do things better but we do not want them to leave." ULND

The interviewees believed that the performance measurement was very important in relationship banking. Firstly, accurate measurement allowed the case banks to identify potential problem areas. Therefore it indicated how these problems could be solved and hence the effectiveness could be improved. Secondly, it provided valuable data, which could be used to strategically drive team objectives. Therefore it was very important to track the progress and adapt the offerings and services according to the changes in customer needs. Thirdly, it also provided useful information to measure individual performance, compare with the other people, and compensate the relationship managers. The incentive system of relationship banking will be discussed in detail later in this chapter.

Metrus Group (2003) provides evidence that performance measurement is powerful in improving business performance because: (1) measurement rapidly forges increased strategic agreement; (2) measurement provides a common language to communicate strategy and key values; (3) measurement helps forge alignment throughout the organization; (4) measurement accelerates the rate of successful change; (5) measurement increases a company's predictive power and early warning capability; (6) measurement helps provide managers with a holistic perspective. Compared with the literature the interviewees were more concerned about practical management of performance issues.

The case banks combined financial performance and non-financial performance measurements. Most interviewees believed that some non-financial measurements were more important because they more cared about the future. The quotes below provided two examples of this.

> "It [performance measurement] is very important but difficult. The obvious measure is a financial one. But I do not think it is a good measure. It is obviously relatively easy to calculate. But I do not think it is good one. We have some targets to measure their performance. For each customer we have, we understand how much income we make from those customers. We could target managers with growing income, for example by a certain percentage of gaining new customers, by selling more products and services to the existing customers. There is a lot of information from the customers in terms of how good the relationships are. We do carry out customer satisfaction surveys using customer satisfaction questionnaires." ULND

> "The bank measures relationship banking using the volume of dealing business such as how much money they lend to the customer, how many financial services it provides to each customer, if the fee income has exceeded interest income as a significant contribution to profit. Sometimes the customers do change their banks but if a relationship stops within two years banks will think "what is wrong with the company?" We measure how many years the customers stay with us. In terms of measuring relationship-banking performance, there are many other measures as well. We measure how satisfied our customers are. We run [customer satisfaction survey] regularly by using an external company to interview our customers in order to give us a good measure how it's performing." SMCC

The case banks used financial measurements including interest and fees incomes from the customers. They also utilised non-financial measurements such as the number of products and services the customer used, the number of years the customer stayed with the bank or customer retention rate. In addition the case banks employed customer satisfaction surveys by interviewing or sending questionnaires to the customers.

Some literatures also argue that it is appropriate to measure both financial and non-financial performance (Kaplan and Norton, 1996). Performance measurement metrics can be classified into different categories such as financial versus non-financial (Ang and Buttle, 2002). Traditional performance measurement focuses on financial indicators including profit, sales and cash flow. Nevertheless, traditional performance systems do not provide a full understanding of the influences on profits. Because accounting metrics have a focus on the short-term and take little account of the value to the firm of long-term customer preference (Ambler, Kokkinaki and Puntoni, 2002). They are not adequate for assessing investments whose benefits will be intangible, indirect or strategic (Grembergen and Amelinckx, 2002). They just look backwards, recording historical data so their prediction power is limited (Yeniyurt, 2003). They are not suitable for strategic decisions (Kaplan and Norton, 1992). They do not measure the value created (Lehn and Makhija, 1996). The non-financial measures are a great tool providing support to the top executives to identify potential problems and assess the success of the companies (Kaplan and Norton, 1996).

Considering about the nature of banking management, the interviewees emphasized that it was necessary to balance risk and return in the performance measurement. The case banks took risk and received return but there was a trade-off between risk and return. Higher return was often associated with higher risk. Therefore seventy percent of interviewees mentioned that they used risk adjusted return. Moreover they were also concerned about the cost of return on assets or equity. The following quotes and similar comments from other case banks indicate that.

> "These relationships do have effects on our performance. We measure each customer in terms of what we've delivered in terms of return on equity (ROE), return on assets (ROA). We go further than that. Risk-adjusted return is employed to value their performance. We call (RAROE) risk adjusted return on equity." UMSR

> "There is a measure based on the cost of capital. We set the profit target and the value based management. The cost of capital is a very value-based management, which we called COCA." SMCC

The interviewees emphasized that the performance measurements needed to balance individual performance with group performance because teamwork was the nature of relationship banking.

> "We apply a balanced score card approach. There are some measures we could apply ... relevant at an individual level. The relationship manager is measured on the number of the customers he has created, and also on the number of customer he has lost and on the financial return he created from their portfolio and on the level of customer satisfaction in that portfolio. Similar measures would be equally appropriate at the team level and corporate level to the overall customer base of the organisation." ULKR

> "There are some measures linked to the quality of relationship management. The first is obviously the size and value created for their customer portfolio. The direct way in terms of measuring the quality is based on customer satisfaction surveys. Those customer satisfaction surveys are done for individual relationship managers and also the managing teams." UMHD

As mentioned in the quotes above, the case banks employed Balanced Score Card approach to measure relationship-banking performance. This approach combined

financial with non-financial measurements, qualitative methods with quantitative methods, and individual performance with team performance. A majority of the interviewees emphasized that the qualitative measurement such as customer satisfaction predicts the future profitability.

Academics and practitioners are paying more and more attention on developing integrative non-financial and financial performance measures. Kaplan and Norton (1996) develop a Balanced Scorecard (BSC), which comprises measures from four different perspectives that have proven to be relevant for management decision-making. They are the financial perspective that measures financial objectives, the process perspective that focuses on the internal efficiency, the customer perspective that shows developments related to the customer base and, finally, the innovation perspective that reflects the company's innovativeness and learning.

Kim, Suh, and Hwang (2003) present a model for evaluating the effectiveness of customer relationship management (CRM) using the Balanced Score Card that captures the various benefits of CRM. The four perspectives are: the Customer Value perspective that measures the financial benefits gained from customers, the Customer Satisfaction perspective that measures the level of satisfaction achieved by products and services, the Customer Interaction perspective that measures the operational excellence of internal processes and multi-channel management and the Customer Knowledge perspective that measures the quality of customer knowledge and data analysis.

Similar to these four-perspective models, the case banks utilized Balanced Score Card methods to measure the benefits from these different perspectives. For example, a former relationship manager from a China based multinational bank commented that.

> "We have some quantitative and qualitative indexes. How much money they keep in my bank, how much intermediary service we have done, how much profit we have earned this year. We investigate customer satisfaction. We also measure the internal procedures to make sure the information channels are fast. We also measure how well we capture customer information and knowledge. In addition to knowing the

customer, we measure our responses, how well we can resolve emergent problems." CMCR

Some studies investigate the relationship between financial and non-financial metrics in performance measurement. Jutla, Craig and Bodorik (2001) show that there is a strong association between non-financial performance measures, such as customer and employee satisfaction, customer and employee retention and quality measures, and financial indicators such as profitability (Nagar and Rajan, 2001). This study found similar results. These efforts to design cross-functional frameworks are a useful step forward to capture the financial, operative and qualitative objectives of CRM but are not yet well developed (Payne, 2000). Therefore the case banks may need to develop more appropriate methods to measure the effectiveness of relationship banking.

7.2.4 Incentive-based compensation

The interviewees perceived that it was the people who had the relationships with customers. It was the employees who did the work and achieved the success. The employees need to be compensated and motivated. The incentive system was an important part of relationship banking because it aligned employee performance with the goals of relationship banking. The following quotes illustrated these points.

> "In banking, people bank with bankers, not with banks. I think you've got to compensate and motivate them [relationship managers]. We will have profile targets, product line targets, profitability targets, some growth targets and payments made for that. The compensation is also linked to the retention of customers and maintaining of relationships, quality of customer service." UMLS

> "We judge our teams and individuals on achievement of their KPI (key performance indicators). Each of our directors has a KPI. So, if they've achieved their KPIs they will be rewarded accordingly. They are appreciated by the organisation. It is a feeling that they are a part of the organisation, which is successful. They are very proud of being in Bank S. A lot of people have been in the bank for a long time." UMSR

"The key component of the measurement is growth. It can be asset growth or profitability growth. Market share can be a useful measure; however, the question is that you need to have a great deal to make, to get a return from each of the customers. You want to cover stable returns and growth at the same time. These are key performance indicators." UMSR

These quotes and similar comments from other case banks demonstrate that the relationship managers were compensated according to their performance. The objective of incentive-based compensation aimed to provide a real incentive for constant improvement and overall excellence in line with an organization's goals. Moreover the compensation system was utilised to attract and retain employees. It was important that organizational goals were clearly defined and communicated to the participants. Basic goals could be the quality of service, cost reduction and profit enhancement. The case banks wanted higher revenue and more profitable customer relationships, and then goals were based on sustained revenue and customer portfolio value. The development of the compensation system was an important contributor to successful implementation of relationship banking.

The compensation system should support organisation's goals and strategies therefore be tied to organization specific interests and performance measurement criteria (Tuzovic and Bruhn, 2005). Banker, Lee and Potter (1996) find that sales, customer satisfaction and profits increased as a result of the incentive program. One study even suggested that incentive programs could improve the quality of decisions made by individuals (Stone and Ziebart, 1995).

In the case banks the employees were paid according to the market benchmark and their performance. The first part of their compensation was related to their working experience and academic level and professional qualification. The second part was related to performance. It was related to the quantitative indexes, such as to what extend they had finished the targets. Moreover there were some qualitative indexes such as their attitude to the customer, customer's satisfaction. The following quotes indicate some of the methods that the case banks utilised to compensate their staff.

> "Our salary rate and bonus rate are competitive against other banks, so employees can receive a fair remuneration package. It also includes share options and so on. Our bank is very kind to many of our employees. We have strong advantages because a lot of directors have been with the bank for 15 or 20 years." UMSR

> "There are a number of means by which we pay ourselves. One is salary. That is a performance rating. How do you perform the job? Have you done more than we expected you to do? Have you shown yourself to be a collective manager? Have you shown you motivate other people? We have salary. We have bonuses, and we also have some share options." UMLS

The literature also mentioned how to design an incentive based compensating system (Schraeder and Becton, 2003). The American Compensation Association attempts to develop the "perfect" incentive program. They proposed achieving this through acknowledging quantitative and qualitative indicators of performance, comparing with other organizations, determining specific incentive pay, developing caps, equally rewarding employees who meet the targets (Romano, 1998).

There were some different methods to pay the employees in the case banks including basic salary, bonus and share options. The basic salary was in line with the market and provided earnings in proportion to the experience, talent and energy an employee brings to the organization. Similarly, Rubino (1995) suggest that a successful compensation system should fit the environment, compare with other organizations, and be fair to all employees and the company.

The bonus was aimed to reward those people who met the requirements and exceeded the expectations. This was designed to motivate and acknowledge each employee's contribution in achieving the organization's goals. Smoot and Duncan (1997) also found there was a systematic relationship between the incentive programs and worker productivity in all of their experiments.

The share options gave employees benefits and also were aimed to keep those employees in the organization. The idea of creating a culture of ownership was a common theme related to incentive programs. Bencivenga (1997) suggests that companies are enhancing performance and becoming more profitable by creating

internal cultures of ownership. This internal culture of ownership helps sharing more information with employees and encourages them to participate in the decisions.

Furthermore the interviewees perceived that the employees were rewarded according to their individual performance but also to their teamwork. The case banks encouraged cooperation among the team members by rewarding the team. The following quotes and some similar comments from other case banks indicate that.

> "We have systems to measure and reward individual performance, and ways of enabling staff to share financially in the overall performance of our company. If we do well as a company, we do well as individuals also. Many employers talk about working in partnership with their staff. We actively do so." ILNG.

> "We've got to make sure our management teams are happy. And we can make sure they are making progress. People realise that we cannot get income alone. It is very much based on the team now. We have individual targets but also it is a team thing. We are in the team, we get measured in the team and we get paid in the team. If one person is not performing very well in the whole team, it would be my role to help that person's performance to improve. We have to be very aware how it is a team responsibility." UMHR.

The incentive-based compensation system needs to enhance connection between employee's pay and his performance (Jensen and Murphy, 1998). It also needs to share team's success with its members (Wilson, 1990). Anfuso (1995) noted that individual incentive programs were losing their popularity, in part, because they do not promote teamwork, quality improvement, and other important business issues. Combining individual performance with team success leads to performance improvement of the whole organisation (Meyer, 1994). The compensation system needs to enhance employees' motivation and responsibility of employees (Caruth and Handlogten, 2001) and also to establish new ways of operation in an organization such as enable cooperation between all the employees (Wilson, 1990).

The interviewees emphasized that in addition to monetary incentives, non-monetary incentives was also critical to motivate and reward employees and thereby supported their missions, goals, and organizational cultures.

> "In order to keep the team happy, you need to provide leadership to the team, make sure they get appropriate training, and make sure they get a good place to work in." UMRD2

> "We look after the people who look after our business. We are proud to offer one of the best packages around. We provide pensions, paid holidays, a health support scheme. We often reward our people with personal gifts, vouchers and paid days out." ULND.

> "We are invested millions of pounds in training. Personal development not only helps people to do their current jobs better, but gives them the new skills they will need in the future. We need leaders who support and help them in their efforts. We conduct employee opinion surveys to monitor job satisfaction, and use this information to take remedial action where necessary." UMBD.

The above quotes show that the case banks rewarded the workforce by providing leadership, opportunities for skill training, safe working environments. It was essential that the employees received the skill and competency training and development they need to succeed. Employees needed to have job-appropriate learning opportunities in which to transform received knowledge into applied expertise: also known as "Experience".

No one incentive program was optimal for all situations because no one program would motivate all employees under all circumstances. Clearly, any incentive would motivate some employees, teams, or organizational units more than others. In addition some employees preferred monetary incentives, whereas other employees found non-monetary incentives more meaningful. To avoid the risk of motivating some employees and not others to achieve high performance, the case banks offered multiple and varied incentives to increase the probability of motivating all their employees according to their individual preferences. Moreover, offering a variety of incentives enhanced the organizations' flexibility to tailor awards for specific circumstances. The organizations indicated that employee confidence and belief in the fairness of incentive programs improved when they understood why certain

employees were rewarded. Moreover, public recognition can serve as an additional motivation for employees to strive for high performance.

7.3 The ongoing actions/interactions

The strategic actions/interactions created the context for relationship banking and facilitated the ongoing action/interactions. The case banks accumulated customer information and knowledge through trust-based personal communications with customers. The relationship oriented corporate culture and customer-centric organization enabled internal cooperation within the team and among divisions. The case banks collected and processed customer information and explored business opportunities. The case banks provided tailored financial products and services to meet customer needs.

7.3.1 Trust-based personal interactions with customers

The interviewees perceived that the relationships between the case banks and corporate customers were developed through the interaction of people who represented the organisations. All of the interviewees emphasized that the personal relationship as a major character of bank-corporate relationships although 50 percent of interviewees also viewed themselves as the representatives of the organisations. As a result they built trust with corporate customers overtime. The case bank interviewees recognised that the exchange of information especially private information with corporate customers was based on mutual trust. The case banks acquired more information and knowledge from customers because of the trust between two parts. Moreover, the case banks predicted that the corporate customer would properly use the fund and return the fund and interest within due time. Therefore the case banks could overcome barriers to transacting and allow lending or other financial services to occur. This section uses case bank comments to discuss these points.

The following quotes and some similar ideas from other case banks illustrated that the personal interactions between the bank managers and their corporate customers. The case banks believed that it was the people who built the relationships.

> "It is a people business. People interact with people. Therefore the people are very important. It matters who you are and that a trust relationship can build up. To me the thing that makes us different is the person not the bank. The customers are looking for a very respectable bank. But there are many very good respectable banks. What makes the differences are the people." UMLS

> "When they get services they don't all think of the banks. But they think about the individual they deal with. They completely think about the individual relationship manager they deal with. They'll choose relationship managers because they want to do business with them. So people do not think they want to bank with bank N. They want the bank because they get on so well with this person. Therefore if you have credible relationship managers and they get well trained you have a competitive advantage." ILNG

However, some bank managers also argued that the relationship managers represented the banks. The following quotes and similar statements from some other case banks indicate that the bank-corporate relationships were built through the people who represented the organisations. The relationship was both organisational and personal level interactions. Therefore the relationship should be kept when the relationship manager moved to other position or left the bank.

> "It is a people business. In any business people buy things from people. In order to build trust, you need to trust the individuals you are dealing with. It is the person, representing the organization, speaking to the representative of the company. I would say it would be both a personal relationship and an organisational relationship." UMBR

> "I think people do business with people. But it is important to remember that the individual relationship banker is a representative, an ambassador, of the institution, that represents the bank in front of the customer. The people, who is sitting at the other side of the desk maybe one of the board members of the company, also represent the entity, which is the corporate customer." UMHD

In the case banks, the relationship between banks and corporate customers were seen as a set of cross-hierarchical communications between two organisations. There were many levels of interfaces between a relationship bank and a corporate customer from the top-level executives to lower level managers. The interviewees stated that the most frequent contacts happened through relationship managers from the banks and financial directors from the corporations. However, the case banks also made contact with corporate customers through other levels. The members of the team communicated with the customers at their own levels. The communications also happened between the senior bank managers and corporate board at the top level of the two organisations. The following quotes and similar remarks from other case banks demonstrate that.

> "So we are very happy to build the relationships with all levels, my level and Johnny's level, my people's level." UMRD2

> "As a financial services organization, in order to keep close relationships with our customers, we need to make sure we have regular contacts at headquarter's level and at local level in the branches." ULND

> "It is a people to people business. There are several relationship levels, our level and the directors' level, even the chief executives' level." CMCR

The literature also mentioned the functions of the cross-hierarchical relationships. Ongena and Smith (2000) argue that in a bank-client relationship the connections between a bank and customer go beyond the execution of simple, anonymous, financial transactions. Holland (1993) argues that a primary concern of the banks is to get close enough to get to know the business plans and long-term strategies of the corporate customer. The top-level communications also provide business opportunities such as the provision of advisory services to the board. This level of relationship also enhances the possibilities for the development of relationships further down both hierarchies.

Moreover, all of the interviewees agreed that bank-corporate relationship was based on trust. In order to improve the level of trust, they needed to keep regular contacts with customers and be consistent over time. The creation of trust in turn leaded to a

good relationship. The level of trust in a relationship could be the most important indicator of whether a good or effective relationship exists.

The interviewees emphasized consistency as an important way to build trust between bankers and corporate customers. This meant developing a consistent attitude, consistent rules, and possibly a consistent way of resolving problems. Therefore the actions and words could be predicted into the future. In order for trust to develop and become the foundation of any relationship, truthfulness needed to be the mortar that held the bricks together. The people needed to do what they said therefore this required them to consider clearly the intent, before communicating it to the other side. Truthfulness allowed both sides to continue to engage with each other and not fear deceptive tactics. The following quotes and similar statements from the other case banks illustrated that.

> "Personal relationships require feeding if they want to grow. We will make regular contacts with the customer. We need to understand what is happening in their business. We need to know when the business changes. That will allow us to assist their business and provide the relevant product at the right time." UMSR

> "We need to deliver what we say we are going to deliver. Equally we need to be able to rely on what we have been told by our customer in terms of the business." UMSD1

> "A very important thing is that you need to keep your word when you do business with your customers. If you told your customer you would help them but you did not, how can they believe you next time? If you promised that you would provide an amount of money for the project but at the end you did not deliver the product, they would not stay with you any longer." UMND

Bryk and Schneider (2003) argue that in the absence of prior contact with a person or institution, participants may rely on the general reputation of the other to assess how trustworthy they are. The more interaction the parties have over time, however, the more their willingness to trust one another is based upon the other party's actions and their perceptions of one another's intentions, competence, and integrity. Trust comes out of what you know or have experienced of them so far therefore establishing trust

needs a long period of time. When the trust between two parties built, they must keep it going and even improve it.

The interviewees perceived that the relationships with corporate customers needed to be maintained and promoted. Any inappropriate behaviours could damage the relationship even terminate the relationships. The case banks could decease their customer share or even lose the business. For example the chief executive of the UK based large bank K remarked.

> "I think at first you do not establish a long-term relationship. You establish a relationship then you hope it is going to be a long-term one. You need to stay with them and you do not produce a fallacy and cause trouble. You've got to always update. There are new products and service being developed into the market. Yes you got to provide them because if you do not somebody else will. If something goes wrong, they will leave the bank and go to another one." ULKC

> "By establishing close relationships, we have opportunities to promote and go forward. The relationship must be established from perceived value. It can be developed from experiences over the years. An element of trust needs to be built over a number of years. However, I think there are a number of large companies who want to deal with a number of banks. Therefore perhaps they have relationships with a number of banks. I think then the bank will face a danger of loosing business if the relationship is slightly weakened." ULAD

Holland (1994) also mentioned the dynamic aspects of relations. Covey (1994) describes trust in a relationship as an Emotional Bank Account (EBA). Keeping commitments, being honest, respectful and kind, a reserve of trust is build up and continual deposit in to the account. However if you are autocratic, threatening, disrespectful, overreact, become arbitrary, ignore the other person or betray their trust, then the EBA eventually becomes overdrawn. A good relationship needs continuing deposits of trust into the EBA.

The interviewees perceived that consistency was important in building mutual trust with corporate customers. In order to be consistent, seventy percent of interviewees suggested that it was very important to reduce the turnover of relationship managers.

Employee retention will be discussed in detail chapter 8. Some customers complained that the relationship managers changed too often therefore it was difficult for them to talk with a new relationship manager. For example the chief executive of the UK based large bank K remarked.

> "Sometimes the relationship between the main bank and the company goes wrong. Why is that? Because the managers in the bank who were responsible for the relationship change every two or three years. But the managers and directors, like the financial director in the company, may be there for ten to fifteen or twenty years. The banks keep changing the managers. They don't leave the bank but they go to another part or they've promoted. If you talk to your customers, the companies or the individuals, the biggest complaint you will hear is the constant changing of their relationship managers." ULKC

Furthermore the relationship managers mentioned that it was essential to achieve rapport with the customers in order to build a climate of trust and respect. Rapport is a good understanding of someone and an ability to communicate well with them[18]. Rapport was achieved when two people could see the other person's viewpoint, appreciate each other's feelings, and be on the same wavelength. Rapport started with acceptance of the other person's point of view. The following quote and similar statements from the other case banks demonstrate that.

> "They [relationship managers] should understand the business, understand the market which our customers work in. It takes some time to know the culture of the company. Industries may different. Who is the best relationship manager representing the bank ... maybe because the relationship manager has experience of managing a large engineering company. They get this background from talking with the company. There is a lot of good rapport developed at this stage. If they have not got their rapport then the relationship manager is not going to talk with the company or the company is not going to talk with the relationship manager. So things will drift apart." UMHD

The Oxford English Dictionary[19]defines trust as "Confidence in or reliance on some quality or attribute of a person or thing, or the truth of a statement". Annison and Winford (1998) believe that trust is the intuitive confidence and sense of comfort that

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[18] *Cambridge Advanced Learner's Dictionary* http://dictionary.cambridge.org/
[19] The *Oxford English Dictionary* http://www.oed.com/

comes from the belief that we can rely on a person or organization without thinking about them. This means that the customers would trust relationship managers or organizations according to their appearances or reputations. However Fukuyama (1995) believes that "trust is the expectation that arises within a community of regular, honest, and cooperative behavior, based on commonly shared norms, on the part of other members of that community." Therefore trust is an attitude that a person adopts towards others, based on "predictable" expectation of honesty.

7.3.2 Internal cooperation

The interviewees perceived that the relationship-oriented corporate culture enhanced relationship-oriented behaviors and therefore enabled cooperation within the team and amongst the bank divisions. A shared sense of purpose, direction, and strategy could coordinate and galvanize organizational members toward collective goals. In relationship banking the corporate customers required many financial products and services and their needs were more complex. It was impossible for any individual managers to deliver all products and services and implement the complicated solutions. Teamwork was a major character of relationship banking.

In the case banks the relationship managers received authorization from high-level bank managers and support from colleagues within the team and from other departments. The following quotes and similar statements from other case banks demonstrate that.

> "The relationship managers are responsible for regular contacts with customers and working with them on a frequent basis to understand their needs. So we make sure that those individuals are provided with the right tools, shared information throughout the systems. The dedicated relationship manager works with his or her team, is someone with authority, and someone who can deliver. A relationship manager will ensure that any issue can be resolved promptly. He or she will have access to a large number of specialists within the Group, in areas such as IT, marketing, HR, finance and legal." IMIH

> "Internally it is based on trust as well. They trust me that I have got the correct information. In the organisation if I do not have the authority, someone else has to

make the decision. That person has to trust me to judge the decision as well. If you want a cash management service, a credit card, a loan, foreign exchange, if I cannot do them by myself then someone else can. I will bring someone very quickly. I do not have to know everything. I know enough and understand the problem, and I have a solution." UMLS

"We provide many products to our customers frequently. There is a team working together on this. You cannot expect in a big society any one individual to have knowledge about everything. A key skill for a relationship manager is being able to surround themselves with experts. They have got a team and cooperate with each other when the customer has a complex need." ILNG

The above quotes indicate that the important role of relationship manager was a hub to connect the customers and internal experts. The case banks divided corporate banking into some teams around some customer segments. They worked together with expertises based on years of experience in working with corporate businesses. All the distinctive financial, banking and advisory specialists were able to support each other and provide a choice of services to suit customers' particular needs. The relationship manager was also supported by the other functional experts in the organisation.

Denison (1990) argues that a common perspective, shared beliefs and communal values among the organizational participants, will enhance internal coordination and promote meaning and a sense of identification on the part of its members. Holland (2001) noted that close teamwork reduced internal transaction or coordination cost in providing a range of financial products and services.

The interviewees perceived that the customer centric organisational structure facilitated the cooperation among team members. Within customer centric organizations customer information could be shared throughout the organization. An integrated technology architecture and data warehouse helped the managers to share customer information across the organisation. All the staff obtained an integrated view of customers. This provided significant processing efficiencies and ultimately enabled the managers to make a quick decision. The following quotes and similar statements demonstrate that.

> "We tend to operate the business in teams. The relationship managers are much more general and supported with a team. Nobody knows everything: sometimes they need go to the specialists. Each team has eight directors—the lower level associate directors looking at financial information, management accounts, auditing accounts, watching at cash flows. So it is also a cooperative team." UMRD1

> "Relationship managers work with clients on a longer-term basis to understand their business and identify their needs. Then in collaboration with product specialists, they devise and successfully implement banking solutions to meet those needs. Close collaboration between relationship managers and product specialists helps us towards optimal solutions and trouble-free implementation." UMND

> "For the very large companies no one person can deliver everything or be an expert in everything to meet their needs. So maybe somebody undertakes foreign transactions, somebody takes care of saving or lending. But the person who owns the relationship can possibly identify the opportunity, realise the opportunity. They work in teams and share customer information." ULAD

The above quotes show that the relationship managers were generalists in the case banks and supported by a group of specialists. The relationship managers were designed to deal with a wide range of problems, suggestions, and solutions and to implement them. The team members were encouraged to establish a business rapport with their opposite members in the corporation. The top-level communications in bank-corporate relationships established support for the lower level communications and the effectiveness of financial products and services delivery. Without enough authorisation and support from the high level managers, it was difficult for relationship managers to implement an appropriate solution to the customer and obtain support from other functional departments within the bank. The internal cooperation within the team and among business divisions was essential for the implement of financial solutions.

Moreover, as mentioned before, the performance measurement and compensation system in the case banks encouraged the cooperation between team members. The employees were measured and rewarded according to their individual performance as well as teamwork.

7.3.3 Information and knowledge management

The interviewees perceived that the case banks exchanged information with corporate customers through multi-level personal communications. These frequent communications over time helped the case banks to learn customers' strategy, new products, new developments, and new insights into old problems. The exchange of information through regular contacts with corporate customers allowed the bank to react quickly and constructively to new opportunities arising in the firm. The following quotes and similar comments from other case banks demonstrate that.

> "Each relationship manager has at a minimum an associate director, a corporate banking manager, a corporate banking analyst, in addition to a further support team, for operations etc. As the relationship with the customer goes through the years, the managers will be speaking to people at their level of the organization, or the financial controller, or whoever. What we are going to make sure is the directors do not just know the chief executive and financial director. They know the sales director and the marketing director and production director and operations director depending on the facts of the company. If the company has spread to a number of locations so there is a multi-layer relationships between the directors and customer." UMND

> "Naturally you will see people have relationships with people. There'll be people in branches and different levels of the company. As a large financial service organisation we need to recognise that we cannot change the future of our relationship with our customers by one or two individuals. We have knowledge and relationships at different institutional levels." ILNG.

The interviewees perceived that the managers could obtain a full picture of customer if they were organized around the customer instead of products. The case banks integrated the information from all of products the corporate customer used. As mentioned before in the case banks corporate customers were divided into some industry groups. The relationship managers with specific knowledge and experience in the particular industry were assigned to look after this customer group. The bank managers accumulated specialized knowledge in this industry area over time. This also helped the relationship managers to understand customers' business and identify customers' needs. Therefore by organizing bank resources around customer groups

the case banks explored the information and knowledge advantages. The following quotes and similar statements from other case banks demonstrate that.

> "We provide relationship banking to the Group's large and medium sized business customers. Customers are served by a network of relationship and industry sector specialist managers who provide local access to an extensive range of products and services, as well as offering business information and support. We have 8000 customers. What we look to do is that we organize some sort of teams in our structure in that we provide an industry-focused approach. So we have got 17 industry teams, most of them are generally based in London. We do have geographic teams in some countries. The particular customer may be from a particular industry, say the retail industry. We can provide industry specialists to the customer through the local team and relationship managers have an industry specialist in retail." UMBR

> "What you do get is a dedicated manager who understands the arena you work in, a friendly, capable person who's prepared to put the time in to get to know your business in considerable detail. That's why the majority of our customers use our services on a repeat basis and why no less than 95% of our clients have been with us for 5-10 years and even more than 10 years. We offer a thorough understanding of your business area, so we know what you're talking about and how your ideas can work. With us you benefit from the input of a dedicated manager and an enthusiastic, solutions-minded team. We're here to listen to your views and to learn about your business. Subsequently we'll offer the intelligent, tailored solutions you need." ULAD

Moreover, in the case banks customer data was assembled from every contact channel — call centers, mail, person-to-person, fax, the Internet and other — to construct an accurate, consistent view of customers across all available channels. As the following quotes demonstrate that.

> "We communicate through typical channels. It might be the Internet, or a special electronic system. It might be a face-to-face meeting. We exchange information on a people-to-people basis and time-to-time basis. When customers have a question we take the first time to answer it." ULBD

> "Maybe the customers come in and talk about their needs or maybe a local branch telephones the customer or invites customers to have a meeting. Maybe we go out

> and see the customer in their office. We talk about our services and products, or just keep them in touch. So the frequency of contacts is very important in order to demonstrate retaining the relationship with the customer." ILNG

> "We meet people on a social level playing golf -- a lot of bankers play golf --- and have a nice chat. We invite customers for lunch. We try to meet our customer in more relaxed places other than in my office." UMHR

The above shows many methods that the case banks employed to communicate with their corporate customers. Thirty percent of interviewees preferred more social and relaxed environment. The personal relationships were well developed and some transactions were easily agreed. Seventy percent interviewees emphasised the importance of face-to-face meetings although the development of technology helped the relationship managers to use more and more other channels to communicate with the corporate customers.

The interviewees argued that managers needed to keep a view toward overall customer profitability rather than in discrete segments of the business. It was critical to have a single, enterprise-wide view of the customer, spanning all touch points and systems. The concept of a single customer view — the ability to understand and leverage every interaction a customer had with the institution — was moving to front and centre in banks' long-term business strategies. A single customer view represented the integration of all customer information, regardless of contact points and channels.

The interviewees perceived that they were provided with accurate and comprehensive information about each customer's background history, current business and anticipated needs. The relationship managers had knowledge to understand their businesses and skills to provide tailored financial solutions for them. The relationship managers needed to have knowledge about the customers and customers' business and the customers' market. Furthermore they needed to have knowledge about the banks products and services, and have the capability to deliver good service. Therefore the case banks had a level of competence including knowledge, skills and

experience to deliver these solutions. The following quotes and similar statements from some other case banks indicate that.

> "The banker-customer relationship is a very confidential relationship based on trust. If you trust me you might tell me more information, even some sensitive information. You know I will keep that secret. If they trust me they will open up to me and tell me their current position and future plans. We want to help them to get there. We can prepare [funding] and be able to help them." UMLS

> "... being able to understand our customers and obtain a knowledge of their business. That really is why, over the last few years, customer relationship as a concept has found a place in the organisation. We are able to record the customers' details of the products and services they may have with the bank, details of how frequently they have been in contact, details about the customer's complaints... We need to have the information available when the customer contacts us." ULND

> "You must have customer information. You must be familiar with the banking business. You must have professional certification. You must have work experience: How long you have been working in our bank and your history of performance. The last one is communication capacity including your appearance and your talking capability and your problem-solving capacity." CMCR

In the case banks, the customer information collective process generates customer knowledge. A customer information process refers to the set of behavioral activities that generate customer knowledge pertaining to customers' current and potential needs for products and services (Li and Calantone, 1998). Customer knowledge is systematic customer information, and customer knowledge competence is based on generating and integrating customer information throughout the organization (Day, 1994a, 1994b).

The literature (see Boot and Thakor, 2000; Berger and Udell, 2002; Hauswald and Marquez, 2000; Shin and Kolari, 2004) argues the relationship banks have a continuous flow of information with corporate customers. Both parts give access to "private" information that tends to remains confidential. The banks engaged in relationship banking gain more appropriate and timely information than in a transactional oriented interaction (Elsas and Krahnen, 2003). Therefore the

relationship banks received with better information about the firm's financial position and its prospects. Because firstly, the bank engaged in relationship banking may have stronger incentives to invest in producing information (Boot, 2000). Secondly, relationship banking implies multiple interactions over time between the firm and the bank. It allows the reusability of information, which translates in lower monitoring costs (Grennbaum and Thakor, 1995). Therefore information asymmetries are overcome more effectively in relationship banking (Chang, 2004).

7.3.4 Relationship transactions

The interviewees perceived that the information and knowledge accumulated in communication helped the case banks to identify customer needs. The relationship managers were responsible for identifying business opportunities and designing financial solutions. By providing suitable financial products and services the case banks satisfied customer needs and received income from these transactions. The following quotes and similar remarks from other case banks indicate that.

> "I think that's the task for any organisation, to make sure they are able to capture, retain and use any relevant information about the customer. It helps them to serve the customers properly, identify and satisfy their needs, and obviously use that information to improve services and products." IMIH

> "The person who owns the relationship can possibly identify the opportunity. They need to gain information because obviously they have to manage the credit risk." ULAD

> "The value you get from the customers transfers to our profit. We are here to make money for shareholders. Nowadays, you do not get them [customers] if you just sit at the desk and make money from occasional transactions on a big customer base. You just need to make contact with them. I guess that is relationship management purpose: getting value from the customers to the bank." ILNG

The interviewees perceived that the customers wanted to do transactions with their relationship banks. The following quotes show that corporate customers wanted to do business with those banks that were able to provide funds, suitable products and good

services. They wanted to do transactions with relationship managers, who could understand their business, for a long period of time. Moreover, They could build their creditability over time.

> "From the customer side, they also want to establish a long-term relationship instead of short-term or individual contract. Because these customers, they do want to achieve their creditability. So they actually come to us expect us, to know about what are they and expect us to know about their track record, to understand them, to understand their business, be able to move on." ULND

> "We've got a company that wants to borrow 5 million. If this is a new customer, he will be going to talk maybe to 4 banks. This new customer will think about the price and how did I like this person and do I believe that person will deliver a good service. Price is important but I do not think it is the most important thing for a big company. I don't believe you win them all the time in price but in the fund availability, the product range, and the service. People make the difference. They want to do transactions with good people." UMLS

> "If you want to buy a mortgage, you know the products and you just go shopping on price. But if you want someone to take a risk by lending to you and monitoring your business, they need to understand your business. The trust you can only build up by a long-term relationship. For the small business you may spend less time with them, for the big corporate you need much more time because it is much more complex." ILNG

The interviewees perceived that by having customer information and knowledge and building mutual trust the case banks could make decisions on lending. By keeping the customer relationships the case banks could cross-sell other products to the customers and received more income. The cross-selling has been discussed in chapter 6 as a causal condition for relationship banking and a way to raise income in chapter 8. This section focuses on the transaction process. The following quotes and similar comments from other case banks demonstrate that.

> "It enables us to understand the customer, understand their credit reference, understand their trading record, and then we will make important decisions on lending products. We are more comfortable funding somebody who has been with us

for some time, because an element of trust has built up over a number of years." ULAD

"We have some teams that not only offer a single product sale, but complete relationship banking for some big national companies. So we may sell products like a loan, be a part of the syndication, and take over their transactions, cash movement." UMRD2

The literature also discusses the transactions in relationship banking in which relationship lending is a major topic. In relationship lending, the lender makes credit decisions according to substantial private information, accumulated over time through the provision of loans, deposits and other financial services (Petersen and Rajan, 1994; Berger and Undell, 1995; 2002; Elsas, 2003). Lenders may rely more heavily on their personal relationship with the potential borrower. Because the lender has provided various types of financial services to the borrower in the past and learnt important related to the probability that the potential loan will be repaid. Personal contacts with the borrower outside the financial realm may also provide input into the loan decision (Elyasiani and Goldberg, 2004).

Boot (2000) argues that relationship banking is the provision of a set of financial products and services. It may include commercial banking, investment banking, and non-bank financial intermediaries. Information asymmetries are central to the literature on financial intermediation (Diamond, 1984; Bhattacharya and Thakor, 1993). Relationship banking is aimed at resolving problems of asymmetric information (Boot, 2000). Degryse and Van Cayseele (2000) argue that the information that banks obtain by offering multiple services to the same customer maybe of value in lending (Degryse and Van Cayseele, 2000). For example, deposit accounts may help the bank in assessing a firm's loan repayment capability.

7.4 Towards defining relationship banking

In this study the actions/interactions of relationship banking were perceived by the case bank interviewees as the means to reduce the information gap with customers and reduce uncertainty in banking and allow lending and other financial service transactions to take place. The strategic actions/interactions created the context for

relationship banking and facilitated the ongoing action/interactions. The case banks treated customer relationship as a source of competitive advantage and organized the resources around customer relationships and developed customer-value based performance measurement and incentive-based compensation to support the ongoing action/interactions. The case banks accumulated customer information and knowledge through trust-based personal communications with customers over time and therefore overcame barriers to transactions. The relationship orientation and customer-centric organization also enabled internal cooperation within the team and among divisions. The trust-based communications with customers and internal cooperation facilitated the case banks to collect and process customer information and explore business opportunities. The case banks overcame barriers to transacting and therefore provided relationship transactions, a full range of financial products and services to customers over time.

All of the interviewees believed that relationship banking was a strategic choice. Relationship banking was the case banks' business strategy in corporate banking. Some other banks could also succeed using the alternative strategies such as transactional banking. A full statement of a selected business strategy should include the objectives, actions, and the process. The following is a working definition of relationship banking adopted for this thesis. It is derived from the interviewee's statements.

Relationship banking is a business strategy in a financial institution to establish long-term relationships with selected corporate customers through trust-based personal communications, to provide a set of transactions based on customer information and knowledge. Relationship banking requires a relationship-oriented corporate culture, a customer-centric organisation, and customer value based performance measurement and incentive system.

This definition claims that the objective of relationship banking is establishing customer relationships, gaining information and knowledge advantages, and providing transactions. According to the resource-based view of the firm (Wernerfelt, 1984; Barney, 1991), customer relationship is a sustainable competitive resource.

Creating customer value is increasingly seen as the next source of competitive advantage (Woodruff, 1997). Customer value has been used in a variety of contexts. This thesis chooses the concept of customer value from the perspective of the value of the customer to the organisation - the profitability they generate from each customer (Woodruff, 1997).

This definition emphasizes the actions in relationship banking, which are trust-based, and personal communications between relationship managers and the corporate executives. Trust is an important determinant of the quality and quantity of information. The case banks were doing a set of relationship transactions based on their customer information and knowledge accumulated overtime.

This definition also emphasizes the strategic actions that facilitate the ongoing actions. Trust needs to be a part of the corporate culture in the procedures, policies and practice of the organization and its employees (Harrison, 2003). A customer oriented culture aims to deliver superior customer value. The employees are organised around customer groups and these customer focused organizational structures provide a foundation for developing and implementing this culture. The customer value based performance measurement system links long-term goals to the specific short-term tactics and actions. It is the bank's employees, not the bank, that actually "have" the relationships with customers. With a customer value based incentive system, the organization's workforce in corporate banking is engaged, enabled and integrated into the strategy.

7.5 Conclusion

This chapter discusses the actions and interactions in relationship banking. Figure 7-1 summarized these themes derived from the interview data. Figure 7.2 extends this idea and shows the strategic actions/interaction and ongoing actions/interactions in relationship banking and the relationships between these actions/interactions. It also shows how this bank behavior interacted with that of bank customers. These case based models form a key component of the grounded theory of relationship banking.

The strategic actions/interactions were relationship orientation, customer-centric organization, customer-value based performance measurement and incentive based compensation. These strategic actions/interactions created the context for the ongoing relationship banking actions/interactions. The ongoing action/interactions were trust-based personal communications with customers, internal cooperation within the team and among divisions, exchange of information with customers and learning of customer knowledge, and relationship transactions.

The common belief in the case banks was that the relationship was a fundamental asset, a source of competitive advantage. A relationship oriented corporate culture was gradually developed throughout the whole organization over time. The relationship-oriented corporate culture enhanced relationship-oriented behaviors. The resources were allocated in order to build and improve the relationship.

The customer centric organisational structure enabled the case banks to realise the relationship-orientated culture and improved the relationship with corporate customer. This organisational structure also enhanced cooperation within the team and among the divisions of the organisation. An integrated technology architecture and data warehouse helped the managers to share customer information across the organisation. The relationship managers obtained an integrated view of customers. The cooperation and teamwork among directors increased the work efficiency and reduced the risk of damaging customer relationship. When one relationship manager left another member within the team could step in.

The interviewees perceived that a strategic performance measurement was also important in relationship banking. It linked relationship-banking objectives to the performance measurements. The Balance Scorecard method in the case banks combined financial indicators with non-financial indicators, short time value with long-term value. As relationship banking in the case banks was usually team or group in nature, it also combined individual performance with teamwork. Because the employees actually had the relationships with customers the performance measurement combined external customer value indicators such as customer satisfaction with internal customer value indicators such as employee satisfaction.

The Balance Scorecard method combined qualitative and quantitative indicators to measure the individual and team performance and compensate them accordingly.

The incentives programmes were linked to short –term profits, as well as the long-term interest of the organizations. Employees were motivated to take decisions in the long-term interests of the banks, by linking the incentive programmes to customer value. The compensation consisted a variety of incentive programs including both monetary and non-monetary components to motivate their employees according to their individual preferences. Furthermore the interviewees perceived that the employees were rewarded according to their individual performance but also to their teamwork. The case banks encouraged cooperation among the team members by rewarding the team.

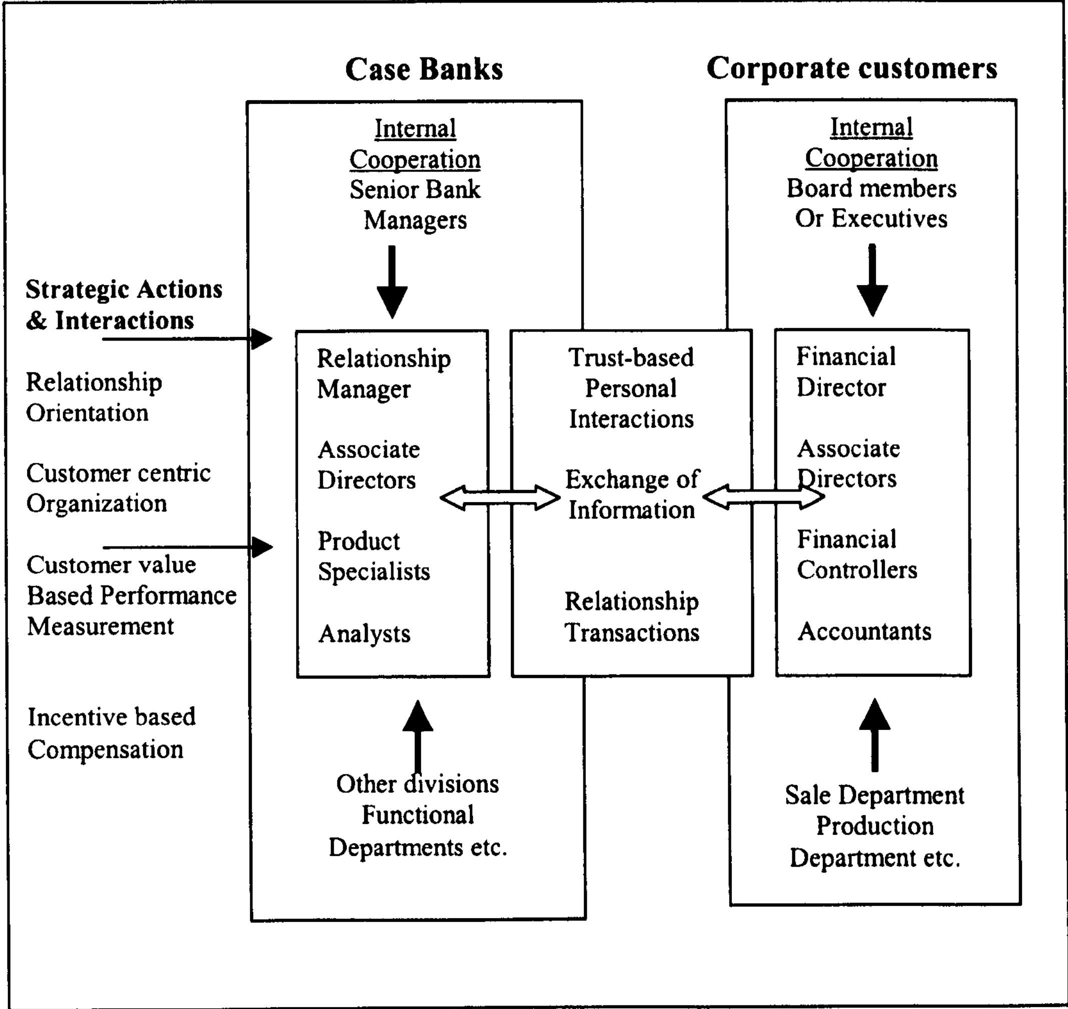
The major character of bank-corporate relationship was trust-based personal interactions. The case banks established personal relationships through multi-level communications. Both parties exchanged information through multi-channel communications. Trust was important for determining the quality and quantity of information. These frequent communications helped the case banks to update customer information. The exchange of information through regular contacts with corporate customers allowed the case banks to learn more customer knowledge and therefore understand customers' businesses and to react quickly and constructively to new opportunities arising in the firm.

A great effort was made to obtain customer information, understand customer business and identify customer needs. Relationship-oriented banks made sure that the collected customer information was shared across the organization. Customer-centric organizational structure enabled cooperation within the team and among divisions. The trust-based personal interaction enabled the case banks to gain more private information. Relationship orientation increased customer loyalty as well as employee loyalty.

The relationship managers understood the customers better and fulfil their needs with suitable products and high quality services. The integration provided employees a full

picture of customer and information and knowledge advantages. Internal cooperation within the team and among divisions made sure that the solutions were delivered properly. Moreover the case banks explored cross-selling opportunities to get more revenues. This provided significant processing efficiencies and ultimately enabled the managers to make a quick decision. The case banks captured the business opportunities and provided a set of relationship transactions.

Figure 7-2 the actions/interactions in relationship banking



Holland (1994) developed a model describing the common ingredients in bank-corporate relationships. Similar to this dissertation the model recognized both banks and firms had multiple relationships, which were developed through a host of environmental influences. However, this dissertation did not find single bank

relationships in Holland's model. The large companies, with turnover more than 100 million pounds, normally had 4 or 5 core relationship banks. From the banks' point of view, they wanted to share risk with other banks especially for those large businesses. From the client firms' point of view, they concerned if they were just dealing with one bank, when the bank changed their credit policy, it could seriously damage their business. Moreover when they wanted to invest a large project, they needed to deal with several banks to get a syndicate loan. Therefore they built credit records with a number of banks. Nevertheless, corporate customers chose one of them as leading relationship bank and allocated a big share of wallet in that bank.

Similar to this dissertation Holland (1994) discussed the cross hierarchy links, transactions and exchanges of information between banks and firm clients. However this dissertation expanded the actions/interactions of the case banks and discussed their internal actions that facilitated the communications with corporate customers. In addition, this dissertation discussed the cross hierarchy interactions in detail, from high-level executives to management team members. Finally, this dissertation discussed the nature of bank-corporate relationships, which were trust-based personal interactions. However, Holland (1994) treated as explicit/implicit contracts and a bargaining process, which were more business concerned.

This chapter discussed the actions and interactions that the case banks adopted under the macro, micro and intervening conditions discussed in chapter 6. These actions/interactions were separated into strategic and ongoing groups. The strategic actions/interactions created a context for the ongoing actions/interactions. The benefits of relationship banking will be discussed in next chapter. These intended consequences were related to corporate customers and the case banks benefits. The intended consequences or benefits of relationship banking for the corporate customers included fund availability, product availability, service quality, in-time help and business platform. The intended outcomes for the case banks included the reduction of credit risk, the increase of income, sustainable profit, customer satisfaction, and employee satisfaction.

Chapter 8 The Intended Consequences in Relationship Banking for Corporate Customers and Case Banks

A corporate banking director in the UK based multinational bank S remarked.

> "I think the funds and products availability are very important. Price is less than that. If your customers feel they are gaining the flexibility they need they will pay for it. We add value to our customers that we understand their real needs and have obligation to help our customers. And we invited a number of people who did not know each other but they all bank with us on a round table to discuss issues." UMSD1

The above quote and similar remarks from other case banks demonstrate some important intended consequences for corporate customers in relationship banking.

A relationship manager in the UK based multinational bank R commented.

> "It [relationship banking] adds value on customer retention because it is much cheaper to keep a customer than get new customers. We can make a profit over a long period. If we have a relationship with them, they may take more than one financial product from us. By knowing and understanding the customers we reduce credit risk. I expect advocacy that they value the relationship and we increase the customer base by word-of-mouth. Every bank can be more or less successful depending on the staff." UMRR

The above quote and similar comments from other case banks illustrate some important intended consequences for the case banks in relationship banking.

8.1 Introduction

Refer to the paradigm model in chapter 5. The previous chapter discussed the actions/interactions in relationship banking under those macro and micro conditions (discussed in chapter 6) in the corporate banking market. These actions and interactions included relationship orientation, customer-centric organisation, trust-based personal communication, customer value based performance measurement and

incentive-based compensation. The interviewees believed that the customer relationship was seen as a source of competitive advantage in the case banks. The case banks established long-term relationships through trust-based personal communications. The human resource and other resources were organized around customers. The customer-value based performance measurements and incentive-based compensation system aimed to support the relationship management. The Balance Scorecard method that combined qualitative and quantitative indicators was utilized to measure the individual and team performance and compensate them accordingly.

This chapter discusses the intended consequences of relationship banking. The benefits of relationship banking for the customer included fund availability, product availability, and service quality, in-time help and business platform. The intended outcomes for the case banks included the reduction of credit risk, increase in income, sustainable profitability, customer satisfaction, and employee satisfaction.

8.2 The benefits of relationship banking for corporate customers

All of the interviewees agreed that relationship banking was of mutual benefit for both selected corporate customers and the case banks. Providing more information helped the case banks to evaluate credit risk and make decisions, and consequently customers got a quick response from the bank. Therefore the corporate customers received necessary financing for their projects and extra transactions because of relationship banking. Moreover the relationship managers believed that they developed tailored solutions to meet customers' complex needs. The case banks developed a broad range of products and services available to the customers. Furthermore they designed specific products according to the customer's particular situations. The case banks priced the financial products and services properly because they had more information and knowledge and understood their business. Thus the case banks delivered the service at right time with right price.

Moreover keeping a long-term relationship with a reliable bank the customers received in-time helps when they had financial problems. The case banks worked

together with customers to resolve the problems rather than precede financial insolvency. The relationship managers also introduced some business opportunities among their customers. These benefits improved customer satisfaction and customer retention.

8.2.1 Fund availability

The interviewees believed that by having a good relationship with a bank the corporate customer could get funds for the projects easier. In most cases bank-corporate relationship involved a lending relationship. Especially for those companies with limited access to capital markets, lending was the main source of funding. In relationship lending, the case banks made credit decisions based on information and knowledge accumulated over time. The borrowers engaged in lending relationship inclined to reveal more proprietary information thus providing the case banks with better information about the firm's financial position and its prospects. Moreover multiple interactions over time between the customers and the case banks allowed the reusability of information. The access to more information linked a competitive advantage of the case banks to lending and positively affected the availability of credit for the customers. Moreover the case banks helped the corporate customers to finance their projects by underwriting securities. Having a good relationship with a reliable bank the corporate customers raised more funds from capital market as they built creditability with the bank over time, which was a positive signal in the market. Furthermore the case banks invested directly into the corporate customer by holding the securities. The following quotes demonstrate the benefit for customers in getting funds from the case banks.

> "By knowing and understanding the customers, what their projects and final plans are, we can react to help customers. It is a very confidential relationship based on trust. We would rather not make that public knowledge. Someone would say that's high risk if someone did not know the company. If you know the company you will say it is not high risk and lend them money." UMLS

> "For instance I have a customer who comes to borrow 18 million pounds from me. Why I can lend him 18 million pounds is because I have confidence in how they

> will use the money. They will use it in a way consistent with what they've told us. That's trust." ULND

> "Because you can act quickly, because you can go inside the customer, you may be able to gain the business with the customer. From the customer's perspective you have a face in the organisation. If things go wrong, the customer knows how you are going to react." UMSR

The interviewees believed that those customers who had long-term relationships with the bank received more funds than new customers. Because firstly the case banks had information and knowledge to understand the business they would like to provide funds to finance the profitable project. Other banks might not think the project was profitable, as they did not understand the specific market. Secondly, the customers did not need to prove themselves again, the relationship bank replied to the requirement quicker than other banks in a competitive market. Thirdly, it was more convenient for relationship managers to monitor the customer. The default risk was reduced because the customer knew that the relationship manager knew them well. The customers believed that a close relationship with banks was valuable therefore they were less likely to break a long-term relationship.

Theoretical studies and empirical findings agree that relationship lending increase the available quantity of capital to firms (Diamond, 1984; Keltner and Brent, 1995; Petersen and Rajan, 1994; Cole, 1998; Ferri and Messori, 2000). The corporate customers could obtain funds by selling securities or borrow from banks. The combination of debt and equity is a way of structuring the governance of companies and therefore influences the behaviour of the managers. Banks lend money to firms and deploy monitoring and supervisory activities (Benston and Smith, 1976; Diamond, 1984) hence reduce agency problems (Jensen and Meckling, 1976). Therefore corporate customers wanted to borrow a large amount of money to finance their projects.

However the existence of asymmetric information leads to adverse selection and moral hazard (Stiglitz and Weiss, 1981). In order to reduce the information gap between banks and customers relationship banking aims at the accumulation of

information over time (Berger and Udell, 2002). Relationship banking facilitates a continuous flow of information between the corporations and the banks and gives access to "private" information that otherwise tends to remains confidential (Boot, 2000).

Some empirical studies (Cerasi and Daltung, 1998; Keltner and Brent, 1995; Elsans and Krahnen, 1998; Petersen and Rajan, 1994; Berger and Undell, 1995) provide evidence that a close lending relationship with a bank will allow the borrower to pay a lower interest rate. But in this study the case banks argued that the interest rate was not lower than in transactional lending. Some researches suggest that relationship lending exposes the borrower to a monopolistic rent, which translate into higher loan interest rates (D'Auria et al., 1999; Degryse and Van Cayseely, 2000). It was not convincing in corporate banking because relationship banking must be of mutual benefit. The case banks argued that if the relationship bank charged high interest rates the corporate customer would leave the bank and go to other banks. Most corporate customers had many relationship banks.

In addition sixty percent of the case banks provided security-underwriting services to help corporate customer to obtain fund from capital market. Forty percent of the interviewees mentioned that they also own customers' shares, bonds and other securities.

> "We will do bond underwriting. We will do share underwriting. This is more specialised. We offer a full range of solutions across all leveraged transactions including equity finance, bond issue programs, securitisations. They are used alone or combined to create financing packages geared to clients' individual needs." UMRS1

> "Over the years, Bank S has made direct equity investments in a number of businesses. We help companies to achieve their acquisitive or organic expansion goals. Our equity team makes investments directly from the bank's balance sheet, not from a fund." UMSD1

The above quotes and similar remarks demonstrate that the case banks helped their corporate customers to obtain more funds by underwriting securities. For those

multinational case banks, they combined traditional commercial banking products and investment banking services. The relationship bank also provided security-underwriting services to their corporate customers. Furthermore having a good relationship with a reliable bank the corporation showed a valuable signal to the market, therefore the corporate customers successfully received funds from capital market. Moreover the case banks made direct equity investments into a number of businesses. The case banks held a certain percentage of customers' shares according to the financial regulation.

The literature supports that the bank-corporate relationship helps the corporate customes to get funds from the capital market. Hoshi et al. (1993) show that bank lending exposes borrowers to monitoring, which may serve as a certification device that facilitates simultaneous capital market funding. Diamond (1991) argues that borrowers may want to borrow first from banks in order to establish sufficient credibility before accessing the capital markets. Again banks provide certification and monitoring. Chemmanur and Fulghieri (1994) show that the quality of the bank is of critical importance for its certification role. Some scholars also argue that relationship lending is considered positively affecting the firm's reputation on the financial market, which is becoming a strategic invisible asset for firms (Hoshi et al., 1990; Lummer and McConnell, 1989). Empirical evidence provided by James (1987), Slovin et al. (1988) and Houston and James (1996) support the certification role of banks.

8.2.2 Product availability

The interviewees perceived that it was essential for the corporate customers to receive suitable products and services. The customers' needs were more and more complex and every customer had specific requirements. The products and services availability were considered when the companies chose and stayed with their relationship banks. The interviewees claimed that they added value to customers by identifying customers' particular needs and designing tailored financial solutions for them. The case banks developed a full range of products and services to meet their

changing needs. Moreover they design new financial products and services to fulfill their particular requirements. The following quotes illustrate that.

> "Because your business is different from other businesses, you will need something different. We listen to what is your business and we should be able to give you a suitable product. As a relationship manager, I will find out information and understand my customer and design a product. We will tailor something to meet someone's need whether it is a financial product or maybe just information." UMLS

> "We provide a full range of products. You find it varies from market place to market place. It is very much about the uniqueness of the customer. As a relationship bank we aim to bring a seamless "one-bank" service to our customers. We understand what is important to our customers and offer a comprehensive product range with the flexibility to tailor individual solutions". UMRD2

> "We'll take the time to get to know and understand your business. We'll be able to match your needs to the most appropriate solutions from our flexible range of products and services. We introduce brand-new products and services to our customer which are tailored for their particular needs. The innovation of new products and services is made by Headquarters and introduced to their customers in this department". ULAD

From above quotes the interviewees believed that the corporate customers had unique financial needs. Knowing customer's needs and expectations and satisfying them by developing products and services were essential for keeping customers.

In the case banks the relationship managers worked with clients on a longer-term basis to identify their needs. The corporate customers were confident that the solutions proposed by the relationship managers were designed to offer the maximum benefit. In collaboration with product specialists, the relationship managers devised and successfully implemented the solutions to meet their needs. The case banks developed a wide range of products and services and prepared to structure the right solution by designing new products and services. Therefore they had the capability to fulfill the customers' various needs.

Some other scholars also emphasized the importance of providing products to meet customers' needs. Lowenstein (1995) argues that companies that fail to use their knowledge of customers to develop the product or service those customers will need are leaving the door open for another company to lure them away. Jiang et al (2003) investigate the case that Ericsson (Nanjing)'s transfer from Chinese banks to Citibank (China) in March 2002. They find that the immediate reason of Ericsson abandoning the Chinese banks is that the Chinese banks cannot offer factoring services to customers. Ericsson tried to use the factoring service to transform its receivable risk to banks and increase its cash flow flexibility. The Chinese banks, however, cannot take the receivable default risk because Chinese banking and insurance industries have been distinctly separated by government regulation. Another reason behind the Ericsson departure is the lack of financial innovation in Chinese banks. This is more important as the organisational structure of Chinese banks is arranged around products instead of around customers. It is impossible to provide tailored financial products and services.

8.2.3 Service quality

The interviewees perceived that relationship banking provided good quality service to the corporate customers. In order to establish and maintain good relationships with corporate customers the case banks focused on customer satisfaction. The service quality was an important factor to satisfy the customers and keep the customer relationships. The case banks put their long-term relationship customers as their priority and allocated experienced relationship managers and other resources to provide good services to them. They quickly responded to their customers and consistently delivered good quality financial services. The following quotes illustrate that.

> "If we give them very good services, they won't want to leave and go to another bank. Because it is hassle for you and it causes problems. As long as they are happy, they should not want to leave." UMLS

> "We deliver good products and financial services to satisfy customers' needs then keep the customers as long as possible. Satisfied customers do not necessarily stay

with the bank but retained customers are satisfied with their banks' services being at least as good as the other banks. Because of the switch cost, customers will not change their banks even if they are not very satisfied with a single transaction but they will leave if they've unsatisfied again and again." UMHD

The above quotes and similar comments from other case banks demonstrate that the interviewees thought that the corporate customers received good quality services in relationship banking. Otherwise the relationship between the case banks and their corporate customers would not last for a long time. Service quality was more difficult for the consumer to evaluate than product quality because of the lack of tangible evidence associated with service. This was especially true for professional services because they tend to be very people based. The interviewees believed that it was essential to respond to the customer quickly and deliver what they want. In practice it was essential to keep the promise and even deliver more than what was promised. For example a relationship manager in the UK based multinational bank S remarked.

"We quickly respond to the customer and deliver efficiently and effectively. In my personal experience, corporations require delivery. It is a value perception, a quality of service perception. Many of the large corporations of the bank have been customers for quite a long time. If you ask them why they remain they would say, because we do it quickly, effectively and efficiently and in a manner to suit them." UMSR

"We deliver what we promised. We promise less but we deliver more. If you promise to do that but do not keep your word or you promise but you deliver less, your customers won't believe you any more. They've disappointed and they lose or fail. They will not stay with you any longer." UMND

In order to make sure that the corporate customers received of good quality services the case banks allocated more resources on them. The experienced banks managers were appointed to take care of customer relationships. The advanced technology was utilized to collect and analyze customer information. The relationship managers spent much time to communicate with their customers and made a big effort to satisfy them. The following quotes and similar comments from other case banks demonstrate that.

"Your dedicated Relationship Manager and his or her team will have experience and knowledge of your industry and will work with you to develop a deep understanding of your company and its banking needs. By knowing your industry and your company, your Relationship Manager will determine ways in which the Bank's full range of products and services can best be tailored to meet your requirements. As your central point of contact, your Relationship Manager will ensure that any issue can be resolved promptly. He/she will ensure that you have access to the large number of specialists within the Bank I Group." IMIH

"Working within a 'continuous improvement' culture, we take our client relationship approach to new levels by constantly investing in new technology, processes and people. Our client base is testimony to this success. All accounts are managed directly through a dedicated Business Banking Centre. Customer information is gathered in the database and analysed using advanced software. Contact with customers is via phone, post, fax, ATM and Internet. Local Relationship Managers are available to provide face-to-face support where required." ULAD

"We put them on our priority list because they are our long-term customers. They are our long-term assets. We will provide good service for them when they have demands. Even more we forecast their needs. We allocate employees to assist their business before they ask for help especially at their peak time. We conducted that in a procedure such as we have a report every week. We must guarantee their cash supply and every department must cooperate." CMCR

Moreover the interviewees perceived that the long-term customers would tell the relationship manager what they were not happy with. These complaints helped the case banks to improve the quality of service. For example a senior relationship manager in the UK based multinational bank L mentioned that.

"A relationship customer should tell you they are not happy with something. If we do not know we cannot solve it. If you've got a relationship with the customer, they will tell you that you need to do something because the customer did not get good service. Complaints are also important for improving our service." UMLS

"The Client Service Team will respond to service issues raised by clients and will monitor the quality of service provided across our product range, providing objective feedback to the client. Our Client Service Management Team is responsible for ensuring clients receive a co-coordinated and consistent service.

The team works closely with the Global Banking Services relationship manager to ensure that the overall product and service proposition is fit for purpose and meets the client's requirements." UMRR

The literature covers many issues of service quality. By definition, service quality construct is the difference between expected service and perceived service (Parasuraman et al, 1985). Service providers must realize that the key to service quality is consistently meeting or exceeding consumer expectations (Bojanic, 1991). The SERVQUAL, an instrument has been used for measuring service quality in many studies (Parasuraman et al, 1985). Some studies find that satisfaction drives a general perception of quality, while others find that perceptions of quality drive satisfaction (De Ruytcr et al, 1997). The case banks indicated that service quality led to customer satisfaction similar to Dabholkar, Shepherd, and Thorpe (2000) and Oliver (1997). The later in turn influences purchasing behavior and therefore customer retention similar to Johnson and Gustafsson (2000) and Oliver (1999).

8.2.4 In-time help

The interviewees perceived that corporate customers received in-time help when they had financial problems. In corporate banking market if a corporate customer changed the banks often the other banks will consider about their creditability and will not accept it. If a corporate customer did not have a close relationship with any banks it will have such a risk that nobody will help them when they have a problem or even worse get into trouble. Every company will have good times and bad times. In an uncertain business environment such as during the war against terror and raw oil price volatility, In-time help is a very important benefit that relationship customers received in relationship banking.

The corporate customers needed to be confident that their banks would help them during difficult situation. This was also the motivation that corporate customers were willing to establish a long-term relationship with the case banks, which was discussed in chapter 6. The following quotes demonstrate that.

"Relationship banking means we should support them through difficult times, not just make money at any time" UMRD1

"You have a very strong relationship once you are in a difficult economy like the 1990's in Asia. You do not panic when the market goes down to an international crisis." ULKR

"Every company will have a bad time. If things go wrong, we will help them when they get into trouble." ULND

"If suddenly the profit goes down, we need to come to see you. We can sort it out , perhaps, to help them." UMLS

The above quotes shows that the relationships between the case banks and corporate customers were long-term in nature. There were some difficult scenarios during this long period of time because of individual companies' own management or environmental changes in the market. In-time help was a very important benefit that corporate customers obtained in relationship banking. If it was temporary financial problems the case banks helped customers to go through this bad time and the relationship could go forward and even deepen. This has been discussed in chapter 6 in detail. For example a relationship manager in the UK based multinational bank S remarked.

When you get difficulties we will try to work together to resolve the problems. We change the contract or put in some money and work it through. If we had a less strong relationship we might be trying to proceed to financial solvency. My experience is that establishing a long-term relationship is much better in difficult situations. UMSR

However if the difficulty was a fundamental problem or persisted for a long time the case banks would terminate the connection. For example a director of corporate banking in the UK based multinational bank H commented.

"If the company gets into significant difficulty, if the company always brings bad news, we maybe have to disconnect that relationship. If that problem is very short term, we will go through that problem and extend the relationship to the future.

But you've probably aware that in the UK, in particular the textile industry, has a significant problem." UMHD

The literature mentioned the implied promise of a close relationship with a bank (Holland, 1993). Implied promise is defined as a promise that is considered to exist despite the lack of an agreement or express terms to that effect and the breach of which may be recognized as a cause of action*. The in-time help was considered by the case banks according to the event, the importance of the relationship instead of any duty or obligation.

8.2.5 Business platform

The interviewees mentioned that the case banks provided a business platform for their customers. The relationship managers introduced their corporate customers to other customers. Moreover the relationship managers provided information and advice to help corporate customers to get business opportunities. The case banks acted as business intermediary to add value to corporate customers. The following quotes and similar remarks illustrate that.

> "And we also do a lot of cross relationships from your point of view. We can introduce our customer base to people such as lawyers and accountants. For example, we held a China dinner because I realised a company has operations in China. And we got a number of customers who have operations in China. So we held the China dinner to share a Chinese meal and Chinese fare. And we invited a number of people who did not know each other but they all bank with us on a round table to discuss issues. We brought a lot of business people to the party not just for a chat and actually created true business value" UMRD1

> "By establishing close relationships we may know customers well and understand their business, and can see what we can do for their business. It is not just the bank providing products and services, but the additional value the bank can bring because we are dealing with many organisations. For example one of my customers was moving their place and leaving some very good furniture and another customer was looking for furniture. I introduced them and helped them to

* www.dictionary.com

> do the business. They both saved money and their relationships with the bank deepened." ULAD

> "You are exporting to China, because of some problems or some issues you come to your bank for some help. Maybe I do not know enough about China and about exporting but as your relationship manager, I will find someone in the organisation to deal with it. Maybe I cannot solve the problem. I will go away and find out the information. Because we are a big group with offices worldwide, we may be able to help you, as if you go to see someone in the Chinese Embassy in London you will get the information. We can tailor our product but we also feed in information to help you. That's again adding value to our relationship." UMLS

The above quotes show that the case banks provided a business platform for their customers to find business opportunities among them. The relationship managers acted as a business intermediary to help their customers to do businesses between them. Moreover the case banks provided information and advice for their customers. The corporate customers gained true business value from the bank-corporate relationships therefore the relationships will go further. Even if there was no actual business value added to corporate customers, they were grateful that they know the relationship managers were interested in their business and enthusiastic of helping them. The relationships were strengthened. For example a relationship manager in an Ireland based large bank remarked.

> "I think we've got to spent time with customers. Obviously if we have something new we would make a call to speak to the customers. We also make them have social events. We're also bringing them information. Very often the relationship is not just around doing transactions with them. We are always there to add value more than they expect and surprise customers. We show the customer that we are thinking of them." ILNG

The literature covers social benefit of customer relationships. Gassenheimer et al (1998) mentioned the social value of the inter-organizational relationship. Customers may be retained by both financial and social benefits because the social value conscious consumer behavior (Antonides and Raaij, 1998). Oliver (1999) argues that Value to Customer emanated form a relationship needs a social or commercial

context for its realization. However little research exists about business intermediary function of relationship banking.

8.3 The benefits of relationship banking for banks

The interviewees perceived that relationship banking was of benefit for the case banks. The case banks identified a chain of connected benefits. Through trust-based personal communications the case banks gained an information and knowledge advantage in the competitive corporate banking markets. By understanding customers' business the case banks reduced credit risk and by gaining more information of customers the case banks were able to explore cross-selling opportunities. In addition, customer retention was more cost effective than customer acquisition. Therefore the case banks obtained sustainable profitability. Moreover, relationship banking improved customer satisfaction thus enabled the case banks to maintain customer relationships. Finally, relationship banking increased employee satisfaction and therefore the case banks retained good experienced employees. The following sections discuss these benefits in detail.

8.3.1 The reduction of credit risk

The majority of interviewees perceived that relationship banking reduced credit risk. Because the case bank that engaged in a long-term close relationship had an information and knowledge advantage. With better information about the firm's credit history, current financial position and its prospects the case banks were able to understand the project and predict the possibility of failure and therefore made better decisions on lending to reduce credit risk. Moreover the case banks monitored the customers properly and therefore reduce credit risk. The following quotes and similar remarks from other case banks demonstrate that.

> "Knowing your customers and understanding your customers does reduce credit risk if you transfer the money to customers. Because you are able to understand who they are, what their needs are, what their projects and final plans are, you can react to help customers to control the effects of credit risk. That's to enable you to reduce credit risk if you have a relationship with your customers". IMIH

> "The more you know the customer, the more you can reduce risk because the biggest risk is because of lack of knowledge. Lack of information is going to risk your business. The more you know the customer, the better the bank you are therefore your business will be better". ILNG

The above quotes show that it was essential that the bank managers had a thorough understanding of every aspect of the customer. The case banks assessed a customer's credit-worthiness on the basis of a detailed analysis of past credit behaviour. By establishing long-term relationships the case banks accumulated valuable knowledge overtime and therefore could understand the projects. The case banks managed the lifetime of bank-corporate relationships thus enabled them to predict customers' future performance better. Therefore case banks made better decisions. Moreover by monitoring the performance of customers and capturing data across all steps and integrating information management with immediate reactions the case banks could reduce default rate.

The interviewees emphasized the private information that the corporate customers shared with the case banks. The private information was not available to the public according to the regulation. By establishing long-term relationship with the customers the case banks got access to private information. For example a corporate banking director in the UK based multinational bank H commented.

> "There is a lot of regulation which applies to public listed companies. There is a lot of information that cannot be shared between the organizations because it is market sensitive. However, we have a company confidentiality agreement. We require certain types of information frequently to stay close to the customer and understand what is happening. Although we are only one part of their business activity we need to understand the rest of their activities. We are able to provide a product relevant to that and assist our customer in doing their business. So regular information exchange is a requirement. There is no substitute to getting sensitive and constructive information except being close to the customer". UMHR

The above quote and similar comments from other case banks illustrated that private information was only available to those banks who established long-term relationship as they had confidentiality agreement. Furthermore corporate customers released

private information because they trust the relationship manager. For example a senior relationship manager in the UK based multinational bank L remarked.

> "The banker-customer relationship is confidential, based on trust. If they trust me they might tell me some sensitive information. We would rather not make that public knowledge. I would hope they are telling me their future plans. They tell me as much as they can so I will even give them some advice or help. So the relationship is so important: they trust me then they will open up to me. It would be better to prepare if they tell me their problems at an earlier stage. We do not like surprises." UMLS

The above quote and similar remarks revealed the nature of bank-corporate relationship that was trust-based exchange of information. The case banks gained private information and therefore made better decisions on lending. Thirty percent of interviewees also mentioned the process of transferring customer information including private information into customer knowledge in relationship banking. For example a relationship manager in the UK based multinational bank R remarked.

> "Many of our relationship managers are not only experts in banking, but are recognized as having specialist knowledge of specific industry sectors. They are able to demonstrate real insight and understanding of the challenges that individual markets face. By working with the company and gaining a thorough appreciation of the unique needs of the company, our relationship managers are able to anticipate and recommend the right solutions at the right time." ULBD

The above quote and similar remarks from other case banks demonstrate that in a customer-centric organization customer information from a variety of products and services was integrated and bank managers had a comprehensive picture of customer. In the customer-centric financial institutions bank managers were organized around several customer groups. Relationship banks might also have an industry knowledge advantage compared with those institutions organized around products. Having information and knowledge was the perceived basis for the case banks to make better decisions and thus reduce credit risk.

Moreover, trust was seen as a valuable asset because both parties spent much time and effort to build the creditability. This reduced the possibility of default of customers in order to avoid the difficulties of future borrowing. Furthermore, when the customers had difficulties to pay back the fund within due time the case banks worked together with customers to resolve the problems. They might negotiate and re-arrange the contract. Banks even lent some more money to help the customers to resolve the problems and recover the bad debt. Otherwise banks might precede financial solvency and get losses from this bad debt. The corporate customers received in-time help to go through the difficulties, which has been discussed in the previous section. For example a relationship manager in the UK based multinational bank B commented.

> "We develop a long-term relationship. We built trust and we are trusted partners which enables us to loosen the product when they have problems completing the contract in due time. This trust relationship really helps us to improve our risk profile." UMBD

Furthermore, the case banks desired to manage and control a wide range of risks beyond credit risk. For example, a relationship manager in the UK based multinational bank H expressed that.

> "There are a number of customers we have who in addition to banking with us, bank with other banks. ...Because banks sometimes share the risk [with other banks] and companies too want to have a number of banks that can be called on for large financing requirements. The syndicate is certainly officially led by one agent bank, which is usually the bank that's got the deepest relationship." UMHR

The literature also discusses risk management in corporate banking. The effective management of risk is critical to the long-term success of banking organisations, as banks are "risk machines": they take risks, they transform them, and they embed them in banking products and services (Bessis, 2003). The biggest risk facing banks remains credit risk, the risk of customer default. Credit risk is simply defined as the potential that a bank borrower or counterpart will fail to meet its obligations in accordance with agreed terms (by The Basel Committee in 1999). In this study, the

interviewees used credit risk as an example to explain how relationship banking reduced banking risk.

Asymmetric information (Stiglitz and Weiss, 1981) between banks and customers commonly creates problems of adverse selection and moral hazard as ex ante screening in approving loans and ex post monitoring of outstanding loans become costly for lenders (Diamond, 1991). Financial intermediaries need to overcome the consequences of informational asymmetries between lenders and borrowers (Hauswald and Marquez, 2000). The banks engaged in long-term relationships have stronger incentives to invest in producing information than in a transactional oriented interaction (Grennbaum and Thakor, 1995). Furthermore, the access of private information linked to relationship banking may point to a competitive advantage of banks in comparison to other financial intermediaries (Fama, 1985).

8.3.2 The increase in income

The interviewees perceived that information and knowledge advantage helped the case banks to explore more business opportunities. Up-selling increased revenue from selling more existing products and financial services to targeted customers. Cross-selling explored revenue opportunities by selling additional financial products or services to existing customers. Moreover the case banks gained more clients and businesses by vocal support from loyal customers. The following quotes and similar comments from the other banks illustrate that.

> "From the bank's point of view, we can share risk with other banks for large business, say 20 million. But we want to get more substantial business". ULAD

> "We have got a certain level of adequate return but are also looking to their share of wallet, the amount of money the company has to spend on financial products and services. If I am competing with other banks, the ambition is to generate greater customer share that has financial services with me." MSCC

Up-selling was the basic practice of moving the customer from a less profitable item in a category to a more profitable one in the same category. By keeping close

relationships with corporate customers, the case banks increase the customers' Share-of-wallet, the proportion of the actual share of total spending on financial products and services.

On the one hand, the case banks collected and maintained information of the existing customers and had an efficient way to access, interpret and use the information. The relationship managers established an understanding of their business, enabling them to provide financial products and services quickly and efficiently. The case banks accumulated data that allows the bank to predict the customers' purchase as well as the frequency. With this forward seeing information, the case banks prepared the funds and human resource to obtain up-selling opportunities. For example, the case bank, which has lent an amount of fund, was more likely to get the up-selling opportunities when the customer wants to expand the borrowing. On the other hand, when customers were satisfied and confident with the bank, they were more likely to give the supplier a larger proportion of their business, or 'share of wallet'.

Moreover the interviewees perceived that a good long-term relationship with a corporate client usually meant that the case banks had a good advocacy in the market place. The corporate customers told their colleagues and friends they had got good products, good responsive services from their bank. It was a much better way to get new clients in corporate market. Furthermore large corporate clients would bring ancillary businesses, because the large corporations were visible in the market place. Their relationship banks were visible to their business partners. They would consider the bank as their own relationship bank. In particular, the smaller businesses or the individuals will choose the bank as well. Therefore the case banks gained more businesses AND increased income. The following quotes and similar comments from other case banks demonstrate this.

> "A good long-term relationship with a corporate client usually means you have good advocacy. A group of customers are telling the market place that they are getting good services and telling their friends and associates that they have a good experience with the bank. That is one main way that we increase our customer base: by word of mouth of our good customers." UMSD1

> "The stronger relationship will bring more business to you. The extra income comes from those relationships that have the next generation such as the son and daughter of the directors. If you build up the relationship with the company you can pick up business from their subsidiaries and partner companies." ULKD

> "Advertising does not work well in corporate banking to acquire new customers. It just gives our employees confidence that our bank is well known. We have a relationship with the executives of the company. We get the chance to pay their employees and their friends because they feel free to have an account with you. If you do a good job with a company you get a chance to do business with their friends and business partners." ULKC

Furthermore sixty percent of interviewees mentioned that more income came from better service, product flexibility, sharing risk with the customers. In corporate banking price was not a competitive advantage because the corporate customers more concerned about fund availability, product availability, service quality rather than low prices. Price mainly depended on risk and service quality. The interviewees perceived that if the corporate customers gained value they would like to pay for it. The following quotes and similar comments from other case banks illustrate that.

> "Because you can act quickly, because you can go inside the customer, you may be able to extend better terms. There might be a cost to the customer by doing that. There might be a premium because it is the customer's choice. They get value and therefore they would like to pay for it." ULND

> "We try to sell joint venture products between the bank and the company. We seek to avoid providing commodity funding because it is cheaper. We introduce interest finance products and joint ventures that have an advantage because we will share the risk, and they will pay for it. You can command a better price, if customers feel they are gaining the flexibility they need for doing current or future transactions. Customers will value the intangible benefit beyond pure price so you offset price by providing good quality and flexibility to the customer." UMSD1

> "Price is important but it won't be the most important thing. Customers do not worry about price, that's my belief anyway. Most customers want good service, and a quick response to him. If you have a good relationship with the customer or partnership, you add value. I do not think they will be concerned about the price

> but the service, the fund availability, and your product range. I don't believe you win them all the time on price." UMSR

All of the interviewees emphasized the benefit of improving revenue from cross-selling. For example, a senior relationship manager from Bank L remarked.

> "When a customer gets services from us, if we have a relationship with them, they may take more than one financial product from us." UMRD1

> "We can make money and go forward, and cross-sell other products. They may have some loans, but we would like to sell them treasury products, business cards, foreign exchange, interest hedging, in addition to that, leasing, purchasing cards", says a corporate banking director in bank UMRR.

> "If I am competing with other banks, the ambition is to generate greater customer share from a range of financial products and services with me. I make a profit from these financial products and services. Some of them will be [interest from] lending products, some of them will be money I charge for the commissions. There will be the money I charge for undertaking their trade work. There will be the money I charge for perhaps organising an acquisition. That is the way I get very good returns". A relationship manager from Bank UMHR

The above quotes show that the case banks gained more revenue from cross-selling. First, they could sell complementary financial products and services in conjunction with core financial products. For instance when the customer had a large amount of loan the case bank could also provide fund transfer service and cash management. Second, they could introduce non-complementary products and services that were not directly related to the customers' existing purchases. For example, when a customer borrowed money to build a building, the case banks could provide property insurance. Third, they could offer new products and services that the case bank innovated. When the bank had new products and services, these could be offered to the existing customers first. Because these customers already had trust with the bank they easily accepted the new products and in turn help the bank to develop new products and financial services.

Many studies argue that cross-selling is a new way for banks to increase their income in nowadays competitive financial market. But only a few studies discuss up-selling in corporate banking although the concept of customer share or share of wallet are well developed in the customer relationship management literature. Retaining customers can lead to increased revenue (Reichheld, 1993; Schlesinger and Heskett, 1991). The loyal customers are more likely to purchase additional goods and services (Reichheld, 1996), and often generate new business for a firm via word-of-mouth recommendation (Reichheld, 1996; Reichheld and Sasser, 1990; Zeithamel, Berry and Persuraman, 1990). It has been shown that banks may be beneficial to offer lending and securities underwriting services (Kanatas and Qi, 1998; Puri, 1999), or lending in conjunction with an equity stake in the firm, or these three services altogether (Rajan, 1992). These works suggest the existence of economies of scope, risk aversion or informational synergies. Santos (1998) shows an additional benefit of cross-selling from the contracting opportunities that arise with the repetition of such multi-dimensional relationships. If the bank and the firm are involved in repeated financial transactions subject to moral hazard, the informed party has much to lose from cheating in one of the relationships, namely the breakdown of both. Therefore cross-selling these services may provide an important competitive advantage over banks that choose to specialize in a single service.

8.3.3 Sustainable profitability

The interviewees perceived that the case banks received sustainable profitability through relationship banking. Maintaining customer relationships helped the case banks to build a stable customer base. Moreover, having a stable customer share the case banks received stable income and hence reduced fluctuation in cash flows. Having a long-term relationship with a customer meant that the case banks received revenue over time and thus reduced uncertainty. By exploring information and knowledge advantage the case banks reduced the possibility of large defaults. Therefore long-term customer relationship was seen as a sustainable competitive advantage for the case banks. The following quotes and similar remarks from other case banks demonstrate that.

> "Fundamentally my job is about generating a sustainable business. Sustainable is a key word there. Sustainability is about maximising returns over the time but reduce volatility of return. In order to do that, we need to have clients and produce a sustainable return over the long-term. I want a deep meaningful relationship because I want to produce a sustainable return over time. It is not about making quick profits. We try to avoid cash inflow and out flow volatility." ULND

> "I want customers to stay for longer rather than charge a high price. If you've got the relationship for ten years, you get income every year. I think the bank is looking for low profitability in the long-term rather than volatile profitability in one year and then cash flow problems. We are looking for a sustainable line of profitability related to the relationship management. So by keeping our market share we can reduce risk. By keeping our customers longer, we can reduce the cash flow volatility. Knowing the customer better can reduce risk." ILNG

> "Relationship banking means that your income stream will be consistent. As we all go through different cycles. If you have a relationship with the customer, you can go to see them and say, we can do something for you, we can do foreign exchange for you, we can do interest hedging. You get an income stream from these customers in ten years and through the cycles." UMRD2

The above quotes indicate that the case banks were more focused on retaining customers to make a stable profit over a longer period of time rather than maximizing profit from a single transaction. With a stable customer base and cross-selling, the case banks had stable income across many relationships clients and across many product areas. The corporate customers who established close relationships with the case banks might commit to allocate a stable share of wallet to the case banks. Especially at the bad time when the economy was in low level, the case banks might still get a stable income stream. By having close relationships with corporate customers the case banks reduced credit risk. The interviewees argued that keeping existing customers was much cheaper than acquiring new customers. Therefore the case banks gained sustainable profitability from relationship banking.

This was consistent with the "law of large numbers" in banking that the bank expects to get higher and stable expected income with lower variance. It is the economy of scale in bank functions to maintain a big customer base and sustain a certain customer

share of wallet, the percentage of customer total expenditure on financial products and services. It is also the economy of scope that the bank provides many financial products and services to the same customer (Lewis and Davies, 1987). The findings in this study are contradicted to the hold-up problem (Rajan, 1992; Boot, 2000). If the customer felt that the case bank charged them high price they might leave the bank and switch to another one.

Most of the interviewees emphasized the future profitability and development. A third of interviewees mentioned that they even did not care much about the money they made previous years and this year. They argued that keeping customers was necessary for survival and future development. The following quotes and similar comments from other case banks illustrate that.

> "The bank needs to maintain profitable relationships because the banking business needs to make a profit. The customer is a source of profitability and nobody survives without customers. Banks want to establish long-term relationships and keep long-term relationships with customers because we need to deliver profit this year and next year. You need a stable growth model. It can be asset growth, profitability growth. It is important that you have a lot of customers which could potentially keep the market share over the short, medium-term and long-term. You want to cover stable returns and growth at the same time." UMSR

> "We expect the business could be 20 years. The customers are going to be successful and we can both benefit from that because it is long-term. I do not think it is a good idea to measure the financial return last year. It is not necessary to make of a lot of money this year because we think they will make a lot of money over the next ten years. Apart from this year you can maintain and you can be stable in growth year after year." ULND

> "We can make profit over a long period of time. If we maintain a strong relationship with our customers there is every opportunity that customers will refer their friends, colleagues, or family to us. There is a certain benefit, which is not in the money; there will be value in terms of new business with real money in the future. IMIH

The alternative theories of the firm suggest that the long-run profit maximization is the firm's objective (Sloman, 2000). However, profits cannot or should not be made

with all transactions. Banks lock in long-term relationships with their customers and make profit over time. The length of the bank relationship has received considerable attention (Harhoff and Körting, 1998; Miarka, 1999; Ongena and Smith, 2001). Moreover, banks are interested in a certain quantity of business from the customer and not only profit (Kalawani and Narayandas, 1995).

The customer relationship has a safeguard function (Gemünden, Schaettgen, and Walter, 1992). Banks establish certain customer relationships, which are held as insurance against crises or difficulties (Håkansson and Turnbull, 1982). The relationship can be seen as a set of in formal insurance contracts in which the banks offer to insure the firm for financial support in investment funding and also financial liquidity. And similarly the firm offers to insure the bank against uncertain demand and fierce price competition by providing the bank with a relatively certain share of its regular banking business as well as the first bite of ad hoc fee business (Holland, 1993). Therefore, maintaining customer relationships results in predictable sales and profit streams (Aaker, 1992).

Reichheld and Sasser (1990) find that even a small increase in customer retention produced a dramatic and positive effect on profitability: a five percentage points increase in customer retention yielded a very high improvement in profitability in net present value (NPV) terms. Increasing the customer retention rate from, say, 85% to 90% represented a net present value profit increase from 35 per cent to 95 per cent among the businesses they examined.

8.3.4 Customer satisfaction

A majority of the interviewees mentioned that customer satisfaction was a strategic objective of relationship banking and major indictor to measure relationship-banking performance. The case banks increased customer satisfaction and retained these satisfied customers. By keeping customers for a long time the case banks created revenue and reduced cost and risk therefore received sustainable profit. Measuring customer satisfaction helped the case banks to improve their service and innovate suitable products. The case banks carried out regular customer satisfaction surveys

using interviews, seminars, and questionnaires. The following quotes and similar comments from other banks demonstrate that.

> "We measure customer satisfaction and we will have a regular customer satisfaction survey." IMIH

> "For those top customers we will make an appointment and go to their office or invite them for a seminar asking for their opinions of our service and demands. For those middle customers we will listen to them for comments and demands. For those ordinary customers will use questionnaires asking for their evaluation." CMCR

> "We do carry out customer satisfactions surveys. Independent institutions also carry out these researches. How we are perceived by customers and non-customers. We measure customer satisfaction and we also measure the perception of companies who bank with our competitors." UMHD

By doing customer satisfaction researches the case banks obtained feedback to make sure that they set the right targets and got the right process. The information from customer surveys facilitated the case banks in identifying customer needs. The case banks utilised customer complaints to improve their service. The following quotes and similar remarks from other case banks demonstrate that.

> "We're very much concerned about customer satisfaction. It makes sure that we set the right strategic target at the beginning. It makes sure that we have got the right process." UMHR

> "We send a survey to our customers. The customers have opportunities to pass on information and we look at the analysis. If they're not happy about a service we will do something about it. LMLS

> "Looking at customer satisfaction you can look at the other side as well. The only way we can improve our service and products we offer is really through the feedback from our customers. UMSD2

The interviewees perceived that there was a positive relationship between customer satisfaction and customer retention. By retaining customers the case banks uncovered

opportunities for revenue creation and cost and risk reduction. These benefits have been discussed in detail in the previous sections. Moreover the satisfied customer recommended new customers and businesses to the case banks. The findings from customer satisfaction research enabled the case banks to improve their service quality and innovate new products and financial services. The following quotes and similar comments from other case banks illustrate that.

> "As long as they are happy, they should not want to leave. My role is to make our customer happy so they do not leave to go to another bank." UMLS

> "We are developing the existing customer portfolio as well as going to the market and looking for other prospects. We are strengthening corporate client service and winning a number of notable contracts." UMHD

> "Rising customer satisfaction levels show we are on the correct course. These figures demonstrate our ability to understand and listen to our customers. It has paid real dividends in the design and launch of new products and services that meet their needs. In addition, most of our customers would recommend us to business partners, associates or friends. The findings of customer surveys will enable us to further improve the level of service we provide." ULKR

However, half of interviewees commented that customer satisfaction decreased during the last few years because of many mergers and acquisitions in the financial market. The integration of organisation needed time and effort to achieve. Meanwhile thirty percent of interviewees argued that customer satisfaction and customer retention decreased because of the shortage of products and services range and lack age of product innovation. The following quotes and similar remarks from other case banks demonstrate that.

> "I think the customer satisfaction has decreased in the UK financial market. There has been a lot happening in banks. There were a lot of mergers, a lot of acquisitions, and a lot of consolidation. Customers received poor service in the last few years. I think the customers suffer." UMLS

> "But because of the competition between banks, the customer will transfer to other banks. One of our top customers moved to another bank because this bank not only has a traditional banking service but also has some other services. At a deep

level our product innovation temporally cannot meet their demand. Although we have a forecasting service, but our product innovation is quite slow." CMCR

The literature also mentions the importance of customer satisfaction. Customer satisfaction is defined as a positive affective state resulting from the appraisal of all aspects of a bank's working relationship with corporate customer (Geyskens, Steenkamp and Kumar, 1999). Satisfied customers represent a real, albeit intangible, economic asset to a firm. Customer satisfaction is a fundamental indicator of the banks past, current, and future performance (Oliver, 1997). The ACSI[20] suggests customer satisfaction predicts the future corporate earnings and gaining competitive advantage and creating shareholder value. Customer satisfaction is a key driver of the long-term relationship between the bank and customer (Geyskens, Steenkamp and Kumar, 1999). Mittal and Kamakura (2001) argues that customer satisfaction affects the orientation toward a long-term relationship. A satisfied customer could utilize the provider again and recommend the provider to other customers. Satisfied customers are more likely to refer others, which promotes profit generation as the cost of acquisition of these new customers is dramatically reduced. In corporate banking customer advocacy can play a very important role in acquiring new customers.

ISO[21] suggests that the organization that enhances customer satisfaction continually improves its performance. Keiningham et al, (2003) find that customer satisfaction is positively related to repurchase intention, actual repurchase, market share, and word of mouth. Customer satisfaction and loyalty have significant reciprocal effects on each other (Lam et al, 2004). Customer loyalty is a customer's overall attachment or deep commitment to a product, service, brand, or organization (Oliver, 1999). Customer loyalty has a powerful impact on firms' performance (Heskett, Sasser, and Schlesinger, 1997; Rust, Zeithaml, and Lemon, 2004; Woodruff 1997). The consequences of enhanced customer loyalty in service firms are increased revenue,

[20] Established in 1994, the American Customer Satisfaction Index (ACSI) is a powerful economic indicator, produced through a partnership of the Stephen M. Ross Business School at the University of Michigan, the American Society for Quality (ASQ), and the international consulting firm, CFI Group.

[21] International Organization for Standardization (ISO), is a non-governmental organization. ISO is a network of the national standards institutes of 146 countries.

reduced customer acquisition costs, and lower costs of serving repeat purchasers, leading to greater profitability (Reichheld, 1993; Reichheld and Sasser, 1990).

Heskett et al. (1997) suggest that customer loyalty should increase rapidly after customer satisfaction passes a certain threshold. The "tremendously satisfied" or "delighted" customers are much more likely to remain customers of an organization than those who are merely "satisfied" (Oliver, Rust and Varki, 1997). Furthermore, loyal customers are much less susceptible to negative information about a service than are disloyal customers (Ahluwalia, Unnava, and Burnkrant 1999). Therefore, there is a reciprocal effect of customer loyalty on customer satisfaction.

The service management literature argues that customer satisfaction is the result of a customer's perception of the value received in a transaction or relationship (Heskett et al., 1997). The customers receive economic benefits in term of monetary and in the form of time saving (Peterson, 1995). Customers also derive social benefits from long-term relationships with service firms (Barlow, 1992; Czepiel, 1990; Jackson, 1993), a kind of friendship, a feeling of comfort and security, trust, and confidence.

8.3.5 Employee satisfaction

The interviewees perceived that employee relationship was a source of sustainable competitive advantage. The employees had the relationships with customers and created value for customers and in turn received revenue from the customers. The employees made profit for shareholders and in the meantime they were compensated according to their performance. Employee satisfaction was another outcome for the case banks in relationship banking.

The case banks recognized that sustainable competitive advantage did not come from products because the competitors could easily duplicate them or from price because the market was more transparent and margin was very low. Long-term competitive advantage comes from the employees. The interviewees perceived that employee satisfaction influenced customer retention and employee attitude to customer.

Customer satisfaction influenced customer retention and bank profitability. Therefore employee satisfaction determined the bank's long-term profitability.

The case banks improved the quality of employees by attracting, maintaining and training people with skills and experience. Performance measurement and incentive compensation facilitated the employee relationship management. The following quotes and similar remarks from other banks demonstrate that.

> "As the long-lasting competitive advantage, what differentiates you is the quality of people. The competitive advantage comes actually through improving the best relationship managers." ILNG

> "We treat our employees equitably and with respect. Employee engagement measures not just job satisfaction, but how connected employees are to their work and the objectives of the business." ULBD

> "Also internally we look at the people. How satisfied they are. We run an annual survey that gives us some ideas of what our people are really interested in and what is really needed to improve and to motivate. If your employees are satisfied your customer will be satisfied. Because those customers will be looked after by staff that are much more satisfied, it leads to an increase in profit." UMBD

The above quotes show that the employee was a source of sustainable competitive advantage in corporate banking. The case banks treated their employees as valuable equity and employee satisfaction was seen as an indicator to measure relationship-banking performance. The interviewees believed that employee satisfaction was related to customer satisfaction and profit.

> "The only thing that really differentiates one bank from another is the people, because the relationship business is a service business, and the products are very simple, money is available everywhere, and particularly when you are going to a market where pricing is not necessarily a determining factor. The people are around the business, deliver the business, and are absolutely key to that. The knowledge people hold is the most important asset of any bank. You have to use high quality employees, with all of the available tools and skills and resources, to provide the best possible services." UMSD1

> "So in banking competitive advantage is very difficult. It is a challenge that it does not last very long but with the exception of the people that you have in your organization. That can be your competitive advantage. Our competitive advantage is maintaining the best customers, equally the best employees, because they're the people who have the relationship. Both of those will attract and will deliver shareholder value." UMSR

> "We think that they can copy our products, and they can copy our processes. But replicating your people is very difficult. That can give you a competitive advantage over the long-term. When you put them together correctly, that enhances your brand, develops your relationships, and deepens your competitive advantage. Then it gives you sustainable earnings." ULND

The above quotes show that in corporate banking it was very hard to gain competitive advantages from product and price. Product innovation could be a source of competitive advantage but it would not last long. Because of the increased competition the margin was very low in corporate banking. It was hard to gain a competitive advantage in price. Moreover the price in corporate banking depends on the project risk. Customer relationship and internal customer relationship or employee relationship were seen as a source of sustainable competitive advantage. Bank-employee relationship was key because without employee the external customer relationship was impossible to be established and maintained. A key aspect of the customer relationship was trust-based personal communications.

> "In common with most businesses, bank H's performance depends on the quality and commitment of its people. Accordingly, the Board's stated strategy is to attract, retain and motivate the very best people. In a business that is based on trust and relationships, bank H's broad policy is to look for people who want to make a long-term career with the organization because trust and relationships are built over time. Remuneration is an important component in people's decisions on which company to join, but it is not the only one; it is bank H's experience that people are attracted to an organization with good values, fairness, the potential for success and the scope to develop a broad, interesting career." UMHR

> "The relationship managers often have a lending background. They have negotiation skills, are good at reporting to customers. They are capable of running a relationship with corporate customer. There is a lot of training about lending

skills, negotiating skills. We focus on attracting, developing and motivating the very best individuals." UMBR

"The quality of employees represents a significant competitive advantage. It values teamwork and collective management. Basic salary and benefits, annual performance-related payments, long-term share plans are used to motivate and compensate the employees. In order to align the interests of staff with those of shareholders, share options are awarded to employees." UMHD

The above quotes illustrate that human resource management was essential to increase the quality of employees. The case banks recruited those people who have a long-term relationship orientation and attracted people with remuneration, good leadership, and equal promotion opportunity. The relationship managers received training to improve their experience, skills and ability to use modern technology. The case banks measured their performance concerning their individual and collective performance and with the aim of improving teamwork. The case banks compensated and motivated their employees with competitive packages including salary, benefits and share options. The interviewees emphasized the importance of share option to improve employee loyalty and reduce agency cost. These actions, which were essential to improve employee satisfaction and established long-term employee relationships with the bank, have been discussed in detail in chapter 7.

"We are responsible for the stakeholders. The staff is a part of the business, the customer is a part of the business, and the shareholder is a part of the business. So it is a balance. It is how to trust the manager and manage the customer and get to the shareholder." UMLS

"We believe that people interact with people, people create value. Increasing internal service quality improves job satisfaction. Satisfied people establish long-term relationships with the customer and provide value to the customer. Customers deliver profit to the bank and shareholders get value. This is a chain, called the service-profit-chain by Harvard Business School in the 1990's." ULKC

"There are at least three pillars to relationship banking, or the stakeholder pillars, including shareholders, customers and employee pillars. Your perfect position is absolutely in the center. Market forces will make the point move constantly. However, we should not move too far away from the center. I just bring it down to

the importance of the customer, because customers deliver any stakeholder value. These three things are incredibly interlinked and important. They do not exist in a vacuum. There is a wide world around us. The economy and society will change today and in the future. With the three parts of shareholder, customer and employee, the balance will constantly move." UMSR

The above quotes show that customers, employees and shareholders were treated as three main stakeholders in corporate banking. These three stakeholders had a collective interest, which was the long-term value of the bank. It was possible that three stakeholders had long-term relationships between them. There was a positive relationship between employee satisfaction, customer satisfaction and shareholder satisfaction in the long run. Employee created value for customers and the case banks received profit from customers. Relationship banking needed to balance the benefits among stakeholders because in the short run these stakeholders competed with each other and wanted to increase their own benefit. For example a corporate banking director in the UK base multinational bank S commented that.

> "It is a chain. We treat our employees very well and they will treat their customers very well, and the customers will pay us very well. We get sustainable returns and growth." ULND

> "In terms of delivering long-term returns, it [relationship banking] does not only deliver long-term shareholder value, but long-term benefits for employees and long-term value for customers. It [relationship banking] does not necessarily respond for all of the three stakeholders at all time, but there is a concept behind that. Each of these three values or three points are needed to be improved or expanded." UMSR

> "How to add value to your own work force? And how to manage that in balancing market pressures, the changing new economy, shareholder expectation. Because shareholder expectation is that costs be reduced, now in most banks, most business, the large costs tend to be the people. However, within banking people are the means to delivering products and services. We need to have a balance of cost, a balance of customer expectations, customer requirements, and customer values." UMSD1

The above quotes show that the three stakeholders had different interests in the short run. The shareholders wanted to reduce cost, which was the benefit for employees. Customers expected more value and low price. It was hard to absolutely balance their benefits but understanding the concept was very important.

The literature also emphasizes the importance of employee in value creation. Narver and Slater (1990) stress that all employees, in all departments, have the potential to contribute to customer value. Grant (1996) and Dess and Picken (2000) argue that the creativity and innovation of employees is the key source of advantage. People are a reservoir of knowledge and capability. They will generate ides to make the organisation successful. Heskett, Sasser and Schlesinger (1997) recognised that there are positive linkages between employees' satisfaction, employee retention, customer satisfaction, customer retention, sales and profitability.

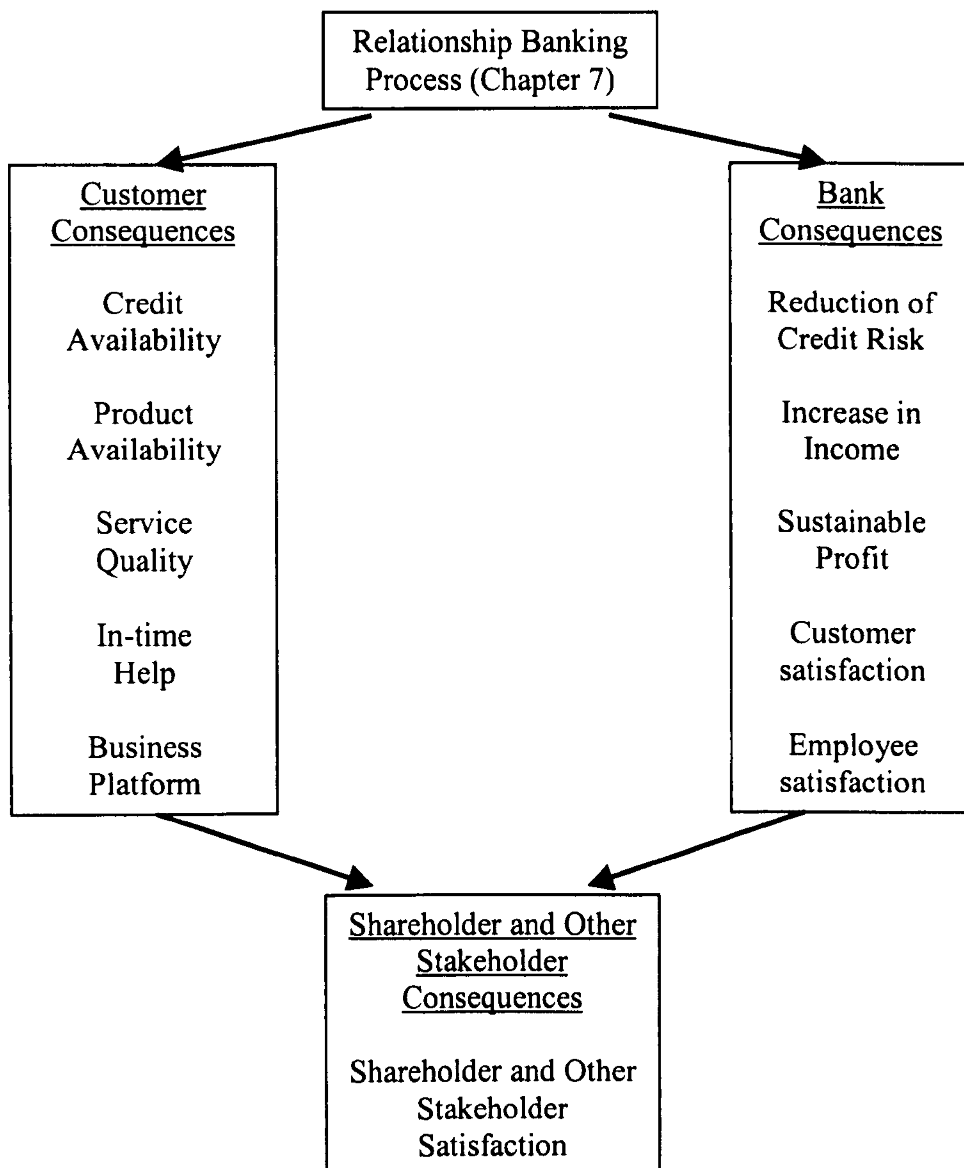
Greene et al (1989) state that the quality of the service is inseparable from the quality of the service provider. They support the notion of employees as customers of employment and the need of internal customer relationship management. Johnson (1996) identifies that rewarding employees correlates significantly with overall customer satisfaction. Jaworski and Kohli (1993) suggest that employees should be rewarded for the achievement of customer satisfaction and building customer relationships. Menon et al (1997) provide evidence for the link between employee reward and behavior.

8.4 Conclusion

This chapter discussed the intended consequences of relationship banking (Figure 8-1). The benefits of relationship banking for the customer included fund availability, product availability, and service quality, in-time help and business platform. The intended outcomes for the case banks included the reduction of credit risk, increase in income, sustainable profitability, customer satisfaction, and employee satisfaction. Moreover, the case banks improved shareholder and other stakeholder satisfaction.

The interviewees perceived that corporate customers received more funds because the case banks accumulated customer information and knowledge over time and therefore the case banks evaluated credit risk and made quick decisions. Moreover the interviewees perceived that corporate customers received tailored solutions because the case banks developed a broad range of products and services and designed specific products according to the customer's particular needs. Corporate customers received high quality services because they were given at priority and consistently quick service with right price. Furthermore due to a long-term relationship with a reliable bank the customers received in-time help when they had financial problems. The relationship managers also introduced some business opportunities among their customers and provided business information and advice.

Figure 8-1 The consequences of relationship banking



The interviewees thought that relationship banking was also of benefit to the case banks. The case banks gained an information and knowledge advantage in the competitive corporate banking markets. Because of this information and knowledge advantage the case banks received a set of benefits from relationship banking. The case banks reduced credit risk by understanding the customers' business. By keeping customer relationships the case banks were able to explore cross-selling opportunities. In addition, customer retention was more cost effective than customer acquisition. Therefore the case banks had a sustainable profitability. Furthermore, relationship banking provided benefits to customers and thus improved customer satisfaction. Finally, relationship banking increased employee satisfaction and therefore retained good experienced employees.

The interviewees perceived that the employee was the origination of value creation. Employee relationship management facilitated the quality of internal services. The employee added value to the customer and increased customer satisfaction and retention in turn the customers delivered profit to shareholders and employees. The value was allocated among stakeholders: customer, employee, shareholder and other stakeholders.

The next chapter will introduce some theoretical implications and empirical suggestions. Moreover the limitations in this study will be discussed and further research opportunities will be identified. Some hypotheses will be proposed for further testing in a large research sample.

Chapter 9 Conclusion

This chapter concludes the dissertation. It summarises the findings and links back to research questions. The chapter integrates the findings to banking, finance and marketing literature. Some theoretical implications and suggestions for management are discussed in this chapter. The chapter also discusses the limitations of the research and identifies further research opportunities. Finally, some hypotheses are proposed for further testing in a broad research sample.

9.1 Summarising the findings and linking back to research questions

Relationship banking was adopted in this study because it was an interesting and important social phenomenon but has not been well researched. A literature review in Chapter 2 shows that the existing relationship banking research is very fragmented and sometimes gives contradictory results. Moreover, in practice, many managers in banks and consulting companies had some misunderstandings about relationship banking. The literature review reveals that no theory is comprehensive and specifically relative to relationship banking. The high-level abstract theories such as information asymmetry and agency theory conventionally applied to relationship banking phenomena can provide a broad and general explanation. Sometimes there may be conflicts in ideas. This study develops a grounded theory of relationship banking, which has own theoretical categories (themes), key variables and causal links between these theoretical elements. This grounded theory provides a "saturated" explanation of themes embedded in grounded phenomenon. It has ability to predict specific interactions only in case relationship banking phenomena observed and investigated in field context. The grounded theory provides a novel qualitative "map" of the space, structure and process of the phenomena as investigated. This grounded theory can act as intermediary between "high" theory and the actual phenomena because some correspondences exists between some high and grounded theory categories, as well as major differences. Thus high theories can use grounded theory to "see through" to phenomena.

Because of the gaps in the literature identified in Chapter 2, this dissertation investigated the main question **(MQ): How does relationship banking create value from bank managers' perspective?** This study explores the value creation in relationship banking from the relationship managers' perspective and offers new insights into and a better understanding of relationship banking. A grounded theory approach (Strauss and Corbin, 1998) was utilised to get insights into the central phenomenon because of the nature of the selected social phenomenon and the characteristics of the research question and purpose. In order to get as close as possible to the phenomenon and people involved, interview was the main method to collect primary data and secondary archival data such as annual reports, was collected to complement the primary data and to cross-check information. The case data was analysed in line with the grounded theory process including open coding, axial coding and selective coding. This study identified six categories of relationship banking and revealed the relationships among these grounded theory elements (Diagram 5-1: A Paradigm Model of Relationship Banking). The dissertation used case quotes to illustrate how these conceptual categories were derived from the case data. A "big picture" of relationship banking was described to get a better understanding of this important and interesting phenomenon. Chapter 5 provided an abstract and "road map" of relationship banking. The findings were presented in three following chapters to cover six broad theoretical categories. The following summarises these findings and links them back to the main research question and interview questions.

In the literature, the reasons why banks and corporate customers establish long-term relationships have not been analysed extensively. Because of the gaps in the literature, this study investigates these problems by asking the interviewees **"why do banks establish long-term relationships with corporate customers (Q1)".** The interviewees perceived that when the case banks chose their business strategy they considered macro-conditions including advances in technology, financial deregulation and business globalisation. The case banks thought that these factors had increased competition in the corporate banking market but also created great opportunities. The case banks had received much competitive pressure from the capital market, foreign banks, and non-bank financial institutions. Thus increasing uncertainties in corporate banking for both banks and their corporate customers.

Under these conditions the case banks were able to quickly and efficiently collect and process customer information, provide a broad range of financial products and services, and expand into other markets and business areas. The case banks adopted relationship-banking strategy to meet the challenge and take advantage of these opportunities. This relationship banking strategy is a response to uncertainties.

Moreover, bank learning over time creates knowledge that also drove the need for relationship banking. The interviewees perceived that knowing the customer and understanding their businesses were essential for reducing credit risk. The case banks also learnt that maintaining customer relationships was critical in cross-selling other financial products and services. The interviewees noted that keeping a customer was more cost effective than acquiring new customers. Therefore the case banks adopted relationship-banking strategy to deal with these external problems including competitive pressure and take advantage of business opportunities.

The case bank interviewees perceived that customer information and knowledge was essential in corporate banking and relationship banking was a good way to obtain more customer information and accumulate customer knowledge over time. The interviewees perceived that the corporate customers also wanted to establish long-term relationships because of the characteristics of customers' financial needs, which were long-term in nature. Moreover, as the interviewees mentioned that every company would have bad times at some point. Hence customer confidence was expected to be built on long-term relationships and the corporate customers expected that the bank would help them when they had financial difficulties. The case banks selected their business strategy considering the characteristics of corporate banking and customer needs and therefore these structural factors were seen as intervening conditions of relationship banking.

The context, causal conditions, and intervening conditions that the case banks considered when they adopted relationship banking as their business strategy were discussed in detail in Chapter 6. These categories were derived from responses of the questions why the case banks wanted to establish long-term relationship with their corporate customers. The interviewees perceived that the case banks adopted

relationship banking as their business strategy and took actions/interactions to implement the strategy, which were discussed in Chapter 7.

Holland (1993, 1994) developed the concept of the bank-corporate relationship. However, this concept was developed from limited fieldwork. Many changes occurred since this work such as the development of information technology, financial deregulation and globalisation and therefore this concept might need to be developed. Moreover fieldwork research methods need to be developed. This dissertation conducts research to investigate "**how do banks establish and maintain these relationships with corporate customers (Q2)**". A strategy is a description of the manner in which a company or enterprise intends to gain a competitive advantage. Strategic management is the process of specifying an organization's objectives, developing policies and plans to achieve these objectives, and allocating resources so as to implement the plans. Strategy implementation involves allocation of resources, assigning responsibility, and managing the process. Managing the process includes monitoring results, comparing to benchmarks and making adjustments to the process etc[22]. However, little is know in the literature about these actions/interactions. Therefore the interviewees were asked **Q3: How do banks measure relationship-banking performance? Q4: How do banks organise and compensate the relationship managers?** These questions covered the actions/interactions when the case banks implement relationship banking as their business strategy. The following findings show how the case banks created value in relationship banking.

The actions/interactions were separated into strategic and ongoing groups. The strategic actions/interactions created context and foundation for ongoing actions/interactions. The strategic actions/interactions included relationship orientation, customer-centric organization, and customer value based performance measurement, incentive-based compensation. The ongoing action/interactions included trust-based personal communications with customers, internal cooperation within the team and among divisions, exchange of information with customers, and relationship transactions.

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[22]Wikipedia, the free encyclopedia http://en.wikipedia.org/

The case banks established long-term relationships with corporate customers through trust-based personal interactions. The case banks exchanged information with corporate customers through multi-level and multi-channel communications. Strategic and ongoing action/interactions created the conditions for trust-based transactions to occur. The case banks provided relationship transactions to their corporate customers including long-term loan and cross-selling a broad range of financial products and services.

The interviewees perceived that customer relationship was a source of competitive advantage. A relationship orientation was a strategic choice of corporate culture. The employees were organized around customer relationships. Moreover, the relationship orientation and customer-centric organizational structure enabled cooperation within the team and among divisions. A customer value-based performance measurement and incentive-based compensation system was essential for relationship banking in the case banks. The Balance Scorecard Card combined with qualitative and quantitative measurements was employed in some case banks to measure relationship-banking performance. Incentive-based compensation motivated relationship managers to build and maintain these trust-based personal relationships with corporate customers.

In Chapter 2, the literature is fragmented in terms of the benefits of relationship banking for banks and corporate customers and the empirical findings are inconclusive. No complete study has been done to systematically investigate the outcomes of relationship banking. In particular, except the overall information advantages, the existing work falls short in that it has not identified the precise benefits of relationship banking for banks (Boot, 2000). Therefore the interviewees were asked "**how do banks and corporate customers get benefits from relationship banking (Q5).** This question covered the consequences or intended outcomes from relationship banking. The consequences were divided into customer and bank consequences.

Chapter 8 presented the consequences or benefits of relationship banking for the customer including credit availability, product availability, and service quality, in

time help and business platform. The intended outcomes for the case banks included the reduction of credit risk, increase in income, sustainable profitability, customer satisfaction, and employee satisfaction. These findings indicated that relationship banking created value for the case banks and corporate customers because they all gained these benefits from it.

The interviewees perceived that by establishing a long-term relationship, the corporate customers were able to gain more funds. With more information the case banks evaluated credit risk and made quick decisions. Moreover the case banks developed tailored solutions to meet the customers' financial needs and thought they priced and delivered the financial products and services properly. In addition, the corporate customers received in-time help when they had financial problems. The case banks re-arranged the debt contracts or provided provide more funds to resolve the problems before financial insolvency occurred. Furthermore, the case banks provided a business platform and thereby facilitated the corporate customers to explore business opportunities among them.

The case banks also received benefits from relationship banking. Regular communications and consistent commitments helped the case banks to build trust with customers and gain an information and knowledge advantage in the competitive financial markets. By understanding customers' business the case banks reduced credit risk. Maintaining customer relationships enabled the case banks to explore cross-selling opportunities and therefore increased in income. In addition, the case banks reduced cost, as customer retention was more cost effective than customer acquisition. Therefore the case banks increased their profit through relationship banking.

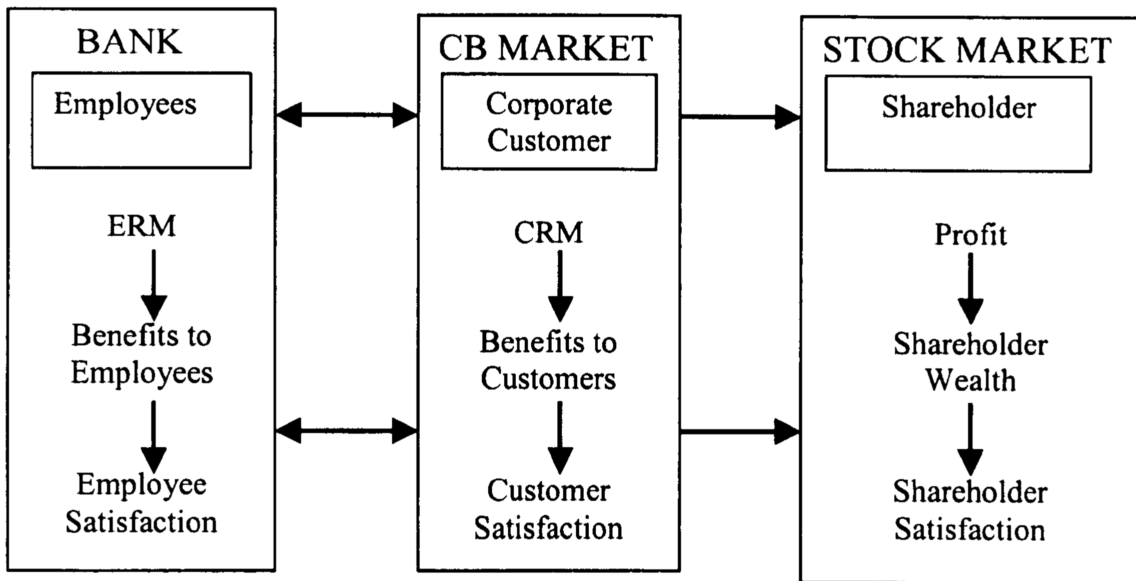
The case banks gained sustainable profitability by keeping a stable customer base and share of business. The interviewees perceived that relationship banking increased the customer satisfaction, which was a critical method to measure the performance and direct the future actions. By establishing good relationships with the internal customers – employees -- the case banks built a sustainable competitive advantage. Keeping good experienced employees and improving their capability of customer

relationship management were perceived as a dynamic learning process in the organisation.

9.2 Integrating the findings and linking to banking, finance, organisational, strategy and marketing literature

This study investigated the process of value creation and allocation in relationship banking from the relationship manager's perspective. Figure 9-1 shows the value creation and allocation process of relationship management inside the case banks, in the Corporate Banking (CB) market and Stock Market. The interviewees perceived that the employee was the origination of value creation. The case banks implemented Employee Relationship Management (ERM) which involved establishing a relationship oriented corporate culture, organizing employees around customer groups, measuring their performance and rewarding them accordingly. The ERM facilitated the internal cooperation and therefore improved the quality of internal services and consequently improved employee satisfaction. The employees added value to the corporate customers through Customer Relationship Management (CRM) in the corporate banking market. These actions/interactions included multi-level and multi-channel communications, the exchange of information, relationship transactions, which were discussed in Chapter 7. The interviewees perceived that the corporate customers gained benefits in relationship banking, including fund and product availability, good quality services, in-time help and business platform, which were discussed in Chapter 8. The case banks increased customer satisfaction and retention and in turn the corporate customers delivered profit to the case banks and consequently added value to the shareholders in the stock market. The interviewees perceived that relationship banking increased shareholder wealth for the case banks and therefore improved shareholder satisfaction. The interviewees thought that employee satisfaction might contribute to customer satisfaction and hence shareholder satisfaction.

Figure 9-1 A grounded theory model of value creation and allocation process of relationship banking for the case banks.



The following section links these findings to conventional banking, finance literature as the findings are related to the relevant literature as suggested by Locke (2001). In this case organisation, strategy and marketing literature are chosen as feasible examples of literature likely to be relevant to relationship banking. They have been chosen because of the presence of organisation, strategy and marketing issues in the case data. This is a way of looking at relationship banking phenomenon in a more integrated manner. It seeks to connect relevant literature in different disciplines and attempts to integrate the fragmented relationship banking literature. Empirical literature concerning relationship banking phenomenon and conventional banking and finance theories (in Chapter 2) can help define broad research area or phenomenon. Moreover prior field research on relationship banking especially Holland (1993,1994) can help the researcher to improve "theoretical sensitivity" in this grounded theory study. This grounded theory of relationship banking is used to fill the weaknesses/gaps in relationship banking literature. This grounded theory of relationship banking could be utilized to connect more relevant "high" level theories and empirical literature for hypothesis generation and testing. The following section also shows an example of combining literature in different disciplines to generate hypotheses.

This study found that the case banks established long-term relationships with corporate customers and obtained information and knowledge about the customers. By knowing the customer and understanding their business, the case banks reduced

information asymmetry with customers and therefore reduced credit risk. These findings were consistent with traditional banking theories.

In the banking and finance literature, the subject of informational asymmetries is the basic reason for the existence of the bank-firm relationship and financial intermediaries in general (Freixas and Rochet, 1997). Stiglitz and Weiss (1981) argue that asymmetric information induces the problems of adverse selection and moral hazard. Diamond (1984), Ramakrishnan and Thakor (1984), and Boyd and Prescott (1986) argue that it is a bank's ability to reduce information asymmetries between borrowers and savers that make a bank unique relative to other financial institutions. Fama (1985) shows that the bank is able to receive "inside" information about its customers through the client-bank relationship. Diamond (1984) emphasizes the monitoring function of banks that reduce agency cost and improve management efficiency (Jensen and Meckling, 1976). Campbell (1979) argues that performing the screening and monitoring functions also encourage the banks to collect customer information.

This study found that the case banks established customer relationships and therefore maintained a stable customer base and explored cross-selling opportunities. In addition to traditional banking products the case banks provided other financial products and services such as insurance, financial derivatives and information intermediation. The findings imply that the role of the bank changed but the importance of the bank as an intermediary did not decline.

Lewis and Davies (1987) argue that the bank has the income and the economies of scale to sustain many product and services functions. This is the law of large numbers in banking that the bank achieves a more stable income by having many relationship clients and operations across many product areas. Berger (1999) argues that banks gathered information beyond public information over time through multiple interactions with customers and through the provision of multiple financial services. Bank relationship does not involve only funding but includes various other financial services and therefore banks obtain information by offering multiple services to the same customer (Degryse and Van Cayseele, 2000). For example, bank-corporate

relationships also play an important role in syndicated loan markets (Dennis and Mullineaux, 1999), private equity and private debt markets (Fenn et al., 1997 and Carey et al., 1993). Thus information asymmetry in one product market was resolved by in formation from another market.

This study found that the case banks considered some macro conditions including the advances in technology, financial deregulation and business globalization when they chose relationship banking as their business strategy. These environmental changes increased the competition in the corporate banking market. Relationship banking was seen as a good way to meet the challenge of increased competition and uncertainty in the corporate banking market.

These findings have made a contribution to the debate in the influence of competition on the development of relationship banking. Contingency theory (Otley, 1980; Fisher, 1995) holds that the choice of business strategies in an organisation may be affected by the external environment. Holland (1993, 1994) noticed that close corporate relationships between firms and their banks were fashioned in a competitive corporate banking market for a wide range of financial services. The research result suggests that financial deregulation and increased competition may induce more relationship banking as external uncertainty is managed by increased relationship certainty for both banks and their customers. Yafeh and Yosha (2001) also argue that increased (potential) competition in the financial services may strengthen bank-firm relationships. However, Petersen and Rajan (1995) conclude that the increased competition in the financial services industry will destroy bank-firm relationships. They argue that market power is a necessary condition for financial intermediaries to invest in relationships with their client firms. Without market power, banks would not be able to extract rents generated by investment in ties with firms, and consequently there would be little or no relationship banking. Using small business lending as a proxy for relationship lending, Ergungor (2005) find that competition reduces the benefits of bank-borrower relationships, making relationship loans more risky and less profitable. This study found that relationship banking was adopted by the case banks as means to respond to the increased competition in the corporate banking

market and thus argues that banks can invest in relationship and counter the destructive effect of competition (Peterson and Rajan, 1995).

This study found that the bank-customer relationship was seen by the interviewees as a source of competitive advantage in corporate banking. The case banks built a relationship oriented corporate culture, customer-centric organisational structure, customer value-based measurement and incentive-based compensation to exploit this advantage. In the corporate banking market, the case banks established long-term relationships with corporate customers by adding value to corporate customers. The interviewees perceived that the corporate customer gained benefits from relationship banking including funds availability, products availability, service quality, in-time help and business platform. These consequences were discussed in detail in Chapter 8.

These findings are related to the resource-based theory (Wernerfelt, 1984; Barney, 1991) and customer value base theory (Woodruff, 1997; Slater, 1997). The Resource Based View holds that firms can earn supra-normal returns if they have superior resources and implement strategies to exploit this competitive advantage. A firm may have many resources and choose any suitable recourse as a source of competitive advantage. Barney (1991) argues that advantage-creating resources must meet four conditions, namely, value, rareness, inimitability and non-substitutability. Woodruff (1997) argues that customer relationship is the next source of competitive advantage. The interviewees perceived that in the corporate banking market, product and price are not appropriate as a source of sustainable competitive advantage. Therefore, relationship banking involving the development of a unique customer knowledge advantage was adopted as a business strategy to establish and maintain customer relationship and generate a sustainable competitive advantage.

The findings support many key points of customer-value based theory. Woodruff (1997) argues that customer value must be the focus of business activities to create and implement a customer value delivery strategy. Slater (1997) proposes four pillars of customer-value based theory: market orientation, continuous learning about customers, commitment to innovation and a customer value process-focused

organization. He defines market orientation as a component of an organizational culture, which aims to deliver superior customer value. While continuous customer-focused learning is conceptualised as the integrated learning processes that develop knowledge about customers, the concept of commitment to innovation is described rather loosely as an emphasis on business renewal. Customer value process-focused organizational structures provide a foundation for developing and implementing the other three pillars.

Drucker (1973) points out that "to satisfy the customer is the mission and purpose of every business" (p.79). Superior performance is the result of providing superior customer value. The customer value creation strategy of a firm substantially influences the scale, scope, and types of activities in which it engages. Firms with strong performance records or with the potential to achieve superior performance can either generate capital for expansion internally or attract new capital in the debt and equity markets. Superior performance tend to be achieved by firms that have a customer value-based organisational culture, complemented by being skilled at learning about customer and their changing needs and at managing the innovation process, and that organise themselves around customer value delivery processes (Slater, 1997).

This study found that customer relationships were seen as a fundamental asset by the interviewees. By establishing long-term customer relationships the case banks perceived that they reduced credit risk, increased in income, obtained sustainable profitability, and improved customer and employee satisfaction. Therefore relationship banking was perceived as creating shareholder wealth in the capital market. Shareholder satisfaction was one of the key objectives of relationship banking and one of the key criteria to measure the relationship banking performance.

In the literature, maintaining customer relationships results in predictable sales and profit streams (Aaker, 1992). Reichheld and Sasser (1996) find that a small increase in customer retention produced a dramatic and positive effect on profitability. Relationships predict whether new value will continue to be created and shared with the company (Gordon, 2003). Customer relationship management is concerned with

the creation, development and enhancement of individual customer relationships with carefully targeted customers and customer groups resulting in maximising their total customer lifetime value (Payne, 2000). Customer lifetime value (LTV) – which is a measure of the profit generating potential, or value, of a customer – is increasingly being considered a touchstone for customer relationship management. Customer lifetime value is usually defined as the total net income a company can expect from a customer (Novo, 2001; Rosset et al, 2002). Shankar et al (2000) show that customer value is a major determinant of shareholder value for dot com companies. More firms are starting to recognize that "customer value" - the profitability they generate from each customer - directly affects shareholder value (Fincentric Corporation, 2001). Stahl et al (2003) provide a conceptual framework for linking customer lifetime value to shareholder value. It is argued that customer relationships have to be treated as assets that increase shareholder value by accelerating and enhancing cash flows, reducing cash flow volatility and vulnerability and increasing the residual value of the firm. However, the literature implies that the total customer lifetime value reflects the market value of the firm. It is questionable to assume that the capital market always efficiently shows the true value of the firm and equals shareholder value. Because it assumes that there is no mis-pricing in capital markets (Gu and Lev, 2001). Moreover, customer value is just another perspective of net present value of total residual income.

In contrast in these resources the interviewees perceived that the bank employee was the origination of value creation and a major source of value. Employee relationship management facilitated the quality of internal services. The employees added value to the customers and increased customer satisfaction and retention and in turn the customers delivered profit to shareholders and employees. The value was allocated among stakeholders: customers, employees, shareholders, and other stakeholders.

These findings lend some support to the theory of service profit chain (Heskett et al, 1997) in explaining the phenomenon of relationship banking. The service profit chain is a framework that shows the direct relationships between profits, customer loyalty and employee capability. The framework proposed that revenues are driven by service quality perceptions, which in turn are driven by operational inputs and

employee efforts. The model argues that organizations need to focus on providing what their employees, customers, investors, and others value most. It proposed that employee value causes the satisfaction, loyalty and productivity that produce value to customer. Satisfied, loyal, trusting and committed customers are the primary drive of company growth and profitability, and determinants of investor value. Therefore, motivating employees will increase employee retention and service quality and therefore result in greater organizational effectiveness and profitability. The service profit chain emphasises the service quality, which this dissertation found to be one of the benefits for customers. Some other factors such as in-time help, fund and product availability, were more important factors that influenced corporate customers to maintain long-term relationships with the case banks according to the interviewees.

This dissertation found that in the case banks, relationship banking balanced the benefits among customers, employees, and shareholders and other stakeholders. The interviewees perceived that the employees created value and the value was allocated among these stakeholders. In the short run, these stakeholders might have competing interests. But in the long run, these stakeholders had a collective interest that was maximising total long-term firm value. Therefore, these stakeholders established long-term relationships to maximise their collective interest – long-term firm value. The Balanced Score Card method combined stakeholders' benefits was utilised in the case banks to measure their relationship banking performance and as a mean to compensate the employees.

The findings in this study reflect the shareholder and stakeholder debate (Smith, 2003). Stakeholder theory holds that managers should make decisions that take account of the interests of the key stakeholders in a firm. Stakeholders are individuals or groups who can substantially affect, or be affected by, the welfare of the firm, including not only the financial claimholders, but also employees, customers, communities, and government officials (Freeman, 1984). However, Cools and van Praag (2000) argue that it is important to set one single target for value creation because companies embracing stakeholder theory may experience managerial confusion, conflict, inefficiency, and perhaps even competitive failure. Jensen (2001) proposes the Enlightened Stakeholder Theory that long-term value maximization or

value seeking is the firm's objective and therefore solves the problems that arise from the multiple objectives that accompany traditional stakeholder theory. This study provided evidence to support Jensen (2001) stakeholder theory. In the long run, employees, customers and shareholder have a collective interest that is maximising long-term firm value. But in the short run, there are competing interests among these stakeholders and relationship banking needs to balance these stakeholders' benefits.

9.3 Suggestions for management

This section briefly considers some implications for bank managers. This study found that the case banks chose relationship banking as their business strategy because of the nature of corporate banking industry and corporate customers. Relationship banking is a good way to do business in corporate banking (Cameron, 2003). But other industries might not be suitable to employ relationship management. Product and price might be the sources of competitive advantages in other industries such as the manufacturing industry. Relationship banking was a selected business strategy in the case banks because they believed in relationship and accomplished action strategies. Because relationship banking required much time, human resource and other resource to establish and maintain close, long-term relationships it might not be an appropriate strategy for other banks. Other banks might choose other business strategies according to their own resources. For example, banks and non-bank financial intermediaries may choose transaction base strategy if the loans and investments are made at arm's length (Boot and Thakor, 1997).

The interviewees perceived that in the retail banking market the individual customers were different from corporate customers in the corporate banking market. Individual customers have now become increasingly concerned about price and switched banks more often. Even corporate customers might have different attitudes and behaviours towards long-term relationships. Therefore relationship-banking strategy needs to focus on those corporate customers who valued a relationship. Moreover the profitability was also different between corporate customers. The Pareto Principle maintains that 80% of revenues comes from 20% of your customers (Koch, 1999). Relationship banking requires much human resource, time and financial expenditure

and therefore needs to focus on targeted customers. Therefore even in the corporate banking market not all customers are worth doing relationship banking with. The interviewees argued that the case banks focused on profitable customers, typically large companies.

However, This does not mean that relationship banking simply ignores those less promising customers. This dissertation suggests that in retail banking market banks can choose transactional banking and compete in product and price, but still invest in customer information management. Knowing customers and understanding customer needs may help banks to gain information advantage and thus increase transactional or retail banks' profitability. For those unprofitable corporate customers, they can be treated in different ways or improved from low level to high level in their customer pyramid by increasing the share of business from that customer.

As mentioned in chapter 1 there has been a misunderstanding of customer relationship management in the literature. Therefore some people misunderstand what relationship banking is. CRM has been "hijacked" by information technology (IT) companies. CRM has also been defined as "data driven" or "IT-enabled" marketing about how organisations use IT to help manage their relationships with customers in order to maximise value creation both for the customer and the company (Ryals, 2004). Furthermore it is misleading that companies buying software can use this to fully manage their customer relationships. IT has an important role to play in enabling companies to record each customer's information (Fletcher, 1999). However, conceptually CRM does not rely on IT. Without specialist software some case banks in this study have established long-term relationships with many corporate customers. Therefore, refer to the discussion in Chapter 7, Customer Relationship Management in corporate banking, Relationship Banking, is a strategic choice, not a technology solution.

This study found that relationship banking was not only concerned with external customer relationship management but also with internal customer (or employee) relationship management. In the cases relationship banking was based on personal trust-based communications. It was the employees who had the relationships with the

customers. Moreover, referring to the value creation and allocation process, which was discussed early in this chapter, the employee was seen as the starting point of value creation in relationship banking. Employees needed to be retained and trained in the pace of their career development. Relationships managers in local branches needed authorisation and support from headquarters. Internal cooperation was crucial for the success of relationship banking. Therefore internal customers – employee relationship management (ERM) need to be integrated with CRM in relationship banking.

9.4 Limitations

This dissertation has some limitations in terms of the research question, findings and the research methodology and methods. First, this study investigates value creation in relationship banking from the bank managers' point of view. The relationship managers perceived customer benefits might be different from customer perceived benefits. The results could be more reliable if the corporate customer benefits could be identified independently and combined with bank managers' perceived customer benefits and customer perceived value.

Second, this dissertation did not identify any problems or cost in relationship banking from the relationship managers' perspective. However, in the literature, some scholars proposed there could be some problems in relationship banking such as "hold-up problem" and "soft budget constrain." The relationship bank has an information advantage that may allow it to "hold-up" the customer and charge high loan interest rates (Sharpe, 1990; Rajan, 1992, Boot, 2000). It is the benefit of relationship banking for banks but cost for corporate customers. Moreover, relationship banking generates switching cost for the borrowers. It is a time consuming and resource consuming process when customers want to change their relationship banks. This dissertation found that there was switching cost in bank-corporate relationships. But corporate customers normally have some core banks and therefore reduce the switch cost. The case banks may charge customers high interest rates and high commission fees only if they provide customer flexibility and share their investment risk. The relationship must be of mutual benefit. The relationship

could be damaged or terminated if the relationship banks always charge high interest rates.

Another cost connected to relationship banking is the "soft budget constraint", which has to do with the potential lack of toughness on the bank's part in enforcing credit contracts that may come with relationship-banking proximity (Boot, 2000). The bank that in the past has already lent money to a firm may well decide to extend further credit to the same borrower in the hope of recovering the previous loans. When the borrowers realize that they can easily renegotiate their contract ex post, they can be induced to exert insufficient efforts in preventing a bad outcome from happening. This dissertation found that the case banks provided in-time financial support when their relationship customers encountered temporary financial difficulties. They re-arranged the previous loan contracts when the customers could not return the fund within due time. However, the interviewees perceived that in-time help was a key benefit for the customers in relationship banking and crucial reason that corporate customers intended to establish long-term relationships with the case banks. It is possible that interviewees had a bias to positive aspects of relationship banking and avoided problematic areas in their responses.

The research recognizes that from the customers' perspective these points might be different. Hence it does not make strong comments on these problems by only investigating relationship managers' views.

Moreover, cultural factors were not considered in the dissertation. Contingency theory (Otley, 1980; Fisher, 1995) tells us that the choice of business strategies in an organisation may be affected by external environment. However, in this dissertation, the specific cultural characteristics of different markets were not covered in this study. The interviewees came from different countries but they did not talk much about cultural differences. Because most of the interviewees were in charge of a regional business and therefore they did not have much cross-cultural experience. One of the interviewees mentioned that culture was not a critical factor in relationship banking. Although people behave differently in different countries but the expectations of the customer are the same in his opinion and experience.

The relationship-banking model was perceived be working similarly in different cultures. The interviewees from different countries did not argue that culture was a problem that obstructed the implementation of a relationship banking strategy. However there was not much case evidence that could demonstrate or negate that. Therefore more research is needed to investigate the cultural factors in relationship banking.

Third, there are some limitations in term of the method – grounded theory in this study. The weaknesses of grounded theory methods have been discussed in Chapter 4 and some actions have been taken as responses to these problems. However there are still some limitations must be recognized here. Sampling in this study was conducted according to the principle of theoretical sampling (Strauss and Corbin, 1998). The case banks were selected not because they were expected to have representative views, but because they were expected to have a variety of views and meet the criterion of theoretical saturation and theoretical generalisation. Other researchers or practitioners may transfer it to other situations where they judge it applicable. It may aid understanding and learning. The grounded theory is an inductive approach to generate theory and "well fit and work" on the case data (Glaser and Strauss, 1967). The findings are different from those created in the positivist sense, and generalised to populations at large.

This research might still have some subjective biases and hence lower replicatability compared to quantitative research. The researcher's prior assumptions and knowledge might have impacts on the process of open, axial and selective coding and therefore on the grounded theory (Glaser, 1995). Although this dissertation has taken into account the common definitions and understanding of key categories, the researcher's biases could have had considerable impact on the identification of categories. For instance, the researcher might be sensitive to the perceptions and views of managers who had strong opinion. Therefore, even if the research could be repeated under the same conditions. It is possible that some other researchers might develop different names and understandings.

Finally, because of the time constraint and the researcher's limited knowledge and experience the developed grounded theory and obtained understanding of relationship banking phenomenon may need to be improved in the future.

9.5 Future research opportunities

This dissertation identified some future research opportunities. First, this research explores the value creation in relationship banking from the bank managers' perspective. Another research may explore the value creation in relationship banking from customers' perspective. A study can be conducted to investigate why customers want to establish long-term relationships with banks, what are the actions/interactions that customers perform to keep these close relationships, and what are the benefits they perceived from these relationships. Moreover, the study may be conducted to identify problems in relationship marketing, for example hold-up problems (Boot, 2000). The financial directors in some corporations can be contacted and interviewed. A grounded theory approach may be suitable to conduct this exploratory research. A grounded theory of relationship banking from customer's point of view could be established to achieve a better understanding about relationship banking.

Second, this dissertation proposed some hypotheses that can be tested in a wider sample or population. It is proposed that there is a positive relationship between relationships banking capability and bank performance. Future research can be conducted to test this hypothesis by employing a quantitative method. A relationship banking capability index could be developed combining strategic and ongoing actions/interactions and a bank performance measurement index can be developed using the balance scorecard method. Data can be collected through structured questionnaires. The correlation between these two scores can be statistically analysed to test the relationship between relationship banking capability and banking performance.

Third, a positive relationship is proposed between employee satisfaction, customer satisfaction and shareholder satisfaction. There were some customer satisfaction models in the literature and a shareholder satisfaction index can be developed

combining some independent variables such as share price, dividend and social responsibilities. An employee satisfaction index can be developed combining compensation, training, and career development. Data can be collected from published customer satisfaction database or through structured questionnaires. A traditional quantitative methodology can be selected to statistically analyse the relationship between employee satisfaction index, customer satisfaction index and shareholder satisfaction index.

Fourth, This study found that the human resource in a bank was a source of sustainable competitive advantage. Human resources can be defined as the pool of human capital under the firm's control in a direct employment relationship (Wright, et al 1994). In resource-based view, human resource management can be implemented to generate strategic capability (Barney, 1991). Future research can be conducted to explore the value creation role of human resource management. A grounded theory approach may be adopted in this exploratory research. Data can be systematically collected from practitioners and processed in line with grounded theory procedures. Some categories can be developed based on the case data and the relationship between these categories can be identified. A model of strategic human resource management can be derived from first hand interview data.

Fifth, it may be possible to identify a relationship between firms' human capital and market value. Human capital is an important assets but it is missing from accounting information, for example on balance sheets. It is assumed that the capital market efficiently reflects the firms' true value, which includes the firms' human capital. Future research can be conducted to link the firms' human capital to market value of the firms. A model can be adopted from the literature to evaluate the firms' human capital or developed from primary study, for example a grounded theory research. The human capital index can be calculated and the firms' market value can be collected from Data Stream and other databases. The relationship between human capital and firm market value can be statistically analysed to test the hypothesis.

9.6 Conclusion

This chapter summarised the findings and linked back to the research questions. Why do case banks establish long-term relationships with corporate customers? The case banks considered macro conditions including the advances in technology, financial deregulation, and business globalisation when they adopted relationship banking. The interviewees perceived that relationship banking was efficient for managing risk, effective for saving cost and necessary for cross-selling. How do case banks establish and maintain these relationships and how do they organise and motivate relationship managers? The case banks built a relationship orientated corporate culture, organised employees around customer relationships and employed customer-value based performance measurement and incentive-based reward system. The employees cooperated inside the organisation and communicated with their customers regularly, exchanged information and provided relationship transactions. How do case banks and corporate customers get benefits from relationship banking? The interviewees perceived that the corporate customers gained benefits including fund availability, product availability, service quality, in-time help, and business platform. The case banks gained benefits including reduction of credit risk, increase in income, sustainable profit, customer satisfaction, employee satisfaction.

These findings were integrated and linked to banking, finance, marketing, or organisation and strategy literature that related to relationship banking phenomenon. The literature is related to some items of relationship banking but each literature offers individual insights. The case banks increased internal service quality through employee relationship management within the organisation and improved employee satisfaction. The interviewees perceived that the corporate customers received benefits in the corporate banking market by customer relationship management. The increased customer satisfaction in corporate markets resulted in customer retention and therefore profit to the case banks. The case banks perceived that added shareholder wealth in capital markets improved shareholder satisfaction.

This dissertation identified some opportunities for future research. A future study can be conducted to explore the value creation in relationship banking from corporate

customers' perspective. This study proposed a positive relationship between relationship banking capability and bank performance. This hypothesis can be statistically tested in a wide sample or population. Moreover, a positive relationship was proposed between employee satisfaction, customer satisfaction and shareholder satisfaction. A quantitative research method can be utilised to test this proposition. Furthermore, this study found that human the human resource in a bank was a source of sustainable competitive advantage. A future study can be conducted to explore the value creation in human resource management. The dissertation also suggested that firms' human capital could be linked to their market value in a future study.

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Appendix 1 Interview letter

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Glasgow G12 8LT

Phone: 141 330 8506

Email: 0009491g@student.gla.ac.uk

3rd March 03

Dear Sir or Madam

I am writing this letter to ask if it is possible that I could have a one-hour interview with you about relationship management in Bank A when you are convenient. I am Yongsheng Guo, a PhD student in Glasgow University. My research topic is the Value Creation in Relationship Banking. I would be grateful if you could share your opinion and experience on follow broad questions.

Why do you establish long-term relationships with customers?
How do you keep close relationships with corporate customers?
How does relationship banking effect bank performance?
How do you organise and compensate relationship managers?
How do you measure relationship-banking performance?

The information will be used only in this research and the outcomes will be published anonymously. I intend to feedback the outcomes of my research and my understanding on relationship banking to you in the near future.

My supervisor professor John B Holland can be contact at +44(0) 141 330 4136 or j.b.holland@accfin.gla.ac.uk

Your help are highly appreciated. I am looking forward to hearing from you.

Sincerely yours,

Yongsheng Guo

Appendix 2 An example of Case data

Case Data of Bank S

Primary Materials

Interview with Mr. R

Interview with Mr. M

Interview with Mr. J

Secondary Materials

1. Web materials about Corporate Banking in Bank S
2. Corporate Banking information from Annual report 2001
3. Corporate Banking information from Annual report 2002
4. Corporate Banking information from Annual report 2003
5. A published interview with Mr. C

Primary Materials

Interview with Mr R, the Managing Director of Corporate Banking in Bank S, at 10 O'clock, Friday, 20th February 2004, at NU House, 11 EG Street, E city, Post Code, Phone number.

G: First of all, from your point of view, why do you establish long-term relationships with your corporate customers?

R: I think what causes you to establish a long-term relationship with corporate customers. Obviously there are a variety of reasons behind this. One of them is to gain knowledge of their business. You are able to quickly respond to any financial requests they may have. The second is that, if you establish a long-term relationship with a customer, you know how your customer is going to react as long as you establish a long-term relationship in terms of providing finance. Another major issue is that a good long-term relationship with a corporate client usually means you have good advocacy in the market place. They will tell their colleagues and friends they get a good service, a good responsive service from their bank. It is a much better way

to get new clients. These are the main reasons you would establish a long-term relationship with the customer. At Bank S we are quite successful, we've got a number of long-term, let's say many years, relationships. We find it is an important part of our business.

When they hit any difficulty we will try to work together to resolve any issues because doing that is much better than the other actions you may take. If you have a less strong relationship you might be trying to take a banking approach to a difficult situation. You need to proceed to financial insolvency, proceed such an approach. We put in some money, we will try to change the formula and work it through. Our experience is far more that, as a result of a difficult situation, with whom we have established a long-term relationship, our action is much better than others, then if the shareholder is a venture capital house for example. So I think that's the reason.

We do have some connections that are very long. Since the bank was established in **** (year number concealed for anonym), many companies have been staying with us. We have a few long-term high profile connections in Scotland. In a number of cases, the relationships go back to a couple of years ago. The relationship is with people, the entrepreneurs who establish the business and do the business. You establish a profitable relationship with individuals.

G: How do you keep these close relationships with your customers?
R: I think that's very important, that you meet people on a regular basis; you meet people on a social level, playing golf, you know a lot of bankers play golf. You try to meet your customer in more relaxed places other than in your office. That's been a nice chat. That's fine.

What you've got to do is to gain a real understanding of your customer's business. They will come to you for a funding request. You are able to add value. Even at the end of the day, what you think is, no, you do not actually think, not whatever they are seeking to do. If you have established a long-term relationship, our customers are far more likely to listen to us. That's not purely being friendly, although we help, but it is

being professional in seeking to make sure that you have an understanding. An understanding is really needed to go beyond.

At all levels of our customers, we are interested in the client, somebody in the cash room, the financial controller. Our people are also speaking to them and understand what their business is. It is not just usually that bankers speak to the entrepreneurs. The customers also speak to us. The relationship has got to be established.

You need to deliver what you say you are going to deliver. Equally you need to be able to rely on what you have been told by your customer in terms of the business. You have to understand what the business is, what they are trying to do through the disclosure of what they are trying to do.

G: How do you add value to your customers?
R: I think the financial product availability is very important. Most banks provide loan products, overdrafts, term loans, loan credits, loan option facilities, guarantees, foreign currency and so on. Traditionally they have foreign currency products so you are hedging interest risk on your foreign currency risk. Almost every bank's got the capacity to provide that. We have a couple of products which allow for that hedge. We call that interest finance products and another we call joint venture products. Interest finance is where we are providing all parts of the funding. We are providing equity, we are providing major debt, and we are providing senior debt.

Generally speaking, it was the venture capital house, which made an investment some years ago. The venture capital house now is seeking an access for their business because their business approach is not capable of producing a kind of IRR return. Traditionally on the venture capital investment you could say well, we maybe get 70 percent of their equity, management debt 30 percent. Under our product, that changes. They have 70 percent. We have 30 percent. What we do have is we get paid on debt as a result of the investment we made. We consider it on a long-term basis. We are not looking for the scale that the venture capital houses are usually looking at. So I suppose it is long-term. It is a part of relationship banking.

You are not investing in that type of companies that you do not have previous knowledge of their business. So we try to sell our individual finance product to, just say, existing corporate banking portfolios of a couple of clients, to management teams who we know have sustainable trading records in their business. The joint venture product, let's just say joint ventures between the bank and companies, is just selling to vehicle companies. We tend to extend that joint venture product to property, house builders, hotels, and we've got one or two that are not trading companies in the general sense. We do not undertake joint ventures with manufacturing companies for example. We do provide integrated finance for manufacturing where they have a good trading record. The joint venture product is very much linked to businesses which are strong in competence. And again we are doing this with our longer standing relationships.

I think that one thing is that we at the bank seek to avoid providing commodity funding. We do not like providing commodity funding because it is cheaper. You are competing with all the other banks within the market. We introduce interest finance products and joint ventures that have an advantage because what we say is that we will share the risk, equity risk, and they will pay for it. The whole funding we provide is at a higher interest margin than if you provide pure senior debt. Again, you can find that even in those customers who presumably were formerly getting commodity funding, you can command a better price, if your customers feel they are gaining the flexibility they need for current or future transactions. You know you can pick up the phone and say this is what I want to do. Probably they will respond. You will be able to command a better price. Price is less important than other negotiation issues otherwise you are in a competing situation, like if you've providing like commodity funding.

G: How do you organise relationship managers?
R: We tend to operate the business in teams. Each team has eight directors, the lower level we call associate directors, the sort of people are in charge of looking at financial information, management accounts, auditing accounts, watching cash flows. All the financial staff come from that business. We have an annually planed budget.

The directors who get the financial information are able to carry out a credit system for the relationship borrower. We have working teams, maybe five or six are taking charge of it. Relationship bankers can get important information from our customers if you have a partnership with the customer. That's what you want to get as a banker. In the situation or scenario where the customer is king, the idea of the bank contains what you think about it. But there are a lot of better situations at the earlier stage. We will put influence in a certain direction, when they are seeking our business. Rather than looking at proposals and projects from a financial standpoint, from a funding standpoint, you may be able to point out issues to customers that they haven't thought through properly.

So establishing a partnership is certainly going to benefit two sides. Again they keep competition out. If banks are not under a long-standing relationship, banks find it is hard to compete, when it comes to providing funding. In the Scottish market it is in many ways, just like that: all the banks tend to be jealous of our customer base. They do not like it. In Scotland what we find is that people do not change bank very often because bankers will seek to protect their relationships. Some banks try to reduce in the prices because of the competition. Probably sometimes you've got to respond to that. You know price reduction is helpful to retain the connections. From time to time it happens, like, very occasionally. Say you are competing on price. If they get a better offer, they should take it. But the bank is at the point that they are not prepared to go beyond. Customers know that if you have established the relationships then customers will value the intangible benefits all of that relationship beyond pure price. So you offset price by providing good quality to the customer and they should have the knowledge that if flexibility is required that will be forthcoming.

G: How can you benefit from relationship banking?

R: I think it adds value very much on the basis of customer retention because it is much cheaper to keep a customer than get new customers. You do not have to spend the same degree of time, effort and market expense and legal cost. I expect too, that again it is one benefit of the advocacy that you have: if you have a group of customers out there who are telling the market place that they are getting a good service; They are getting a bank in that way, and they appear to calculate the risk, if

they value the relationship. That is the one main way by which we increase our customer base, by word of mouth, and by our good customers telling their friends and associates that they have a good experience with the bank. Every bank I think is trying to do that and you can be a more or less successful one depending on the professionalism of your staff because the bank's greatest asset is staff.

We have got very a good market share in corporate banking in Scotland but in England it is not really the case because we do not have the same legacy loan book as the traditional clearing banks. In Scotland we do have a good market share. I think through the fact that we've managed to capture most of the successful entrepreneurs in the Scottish market. We are more helpful in the corporate market place. They bank with us rather than bank with anybody else. And we are pleased about it and obviously we would like to see that continue. There are a lot of restrictions like some of our competitors in particular Bank R. So Bank R invests in relationship banking that raises problems against us. Quite a lot of banks do so but they are responsible for the capability.

Let's come back quickly on some issues. I think it's not Bank R or us who make decisions. If they [customers] have strong relationships with you, you can do things which are quickly doable. They understand you have the customer's business in mind. It is very difficult to get that understanding a hundred miles away in another country.

Another competitor is Bank L who are seeking to get market share. But again they are starting with their fairly low base. They are trying to improve their market share. And in certain situations we have to share risk, in a syndicate. L bank has been a willing participant in a syndicate as a means of increasing their corporate profile in the Scottish market place. So I think, perhaps, they want to participate. For us, we offer to syndicate with L bank rather than with those who are a direct competitor such as R Bank. There are quite a few banks that tend not to but we tend to have, say, a dialogue, a real advertise, in terms ours credit exposure.

Many big customers will try to bank with several banks to get a syndicated loan. There are a number of customers we have who, in addition to banking with us, bank with other banks on bilateral bases. We can offer the same type of facilities governed by a document, the same facility letter, but bilateral bases always are a part of the syndicate. It is certainly officially led by one agent bank, which is usually the bank that has got a big part of the business, so that the large corporate connections are very often multi-bank relations because banks sometimes share the risk and companies want to, on occasion, have a number of banks that can be called on for large financing requirements, so that they are available to them for funding. Some of other banks that have longer time standing not advertising customer base may not try to participate. There you can still have a long-term relationship but in that situation the funding may generally be granted to more commodities. Pricing is also important. In the multi-bank situation pricing may take on more importance because you are not in the same position to provide flexibility because the other banks you involved with are actually often governed by the most powerful banks, which seek the title of governors. In the other conditions, funding is often granted on a commodity product. The companies are seeking to gain the best price.

G: How do you measure relationship banking performance and how do you compensate them and keep them working actively?
R: I think you've got to compensate them, you've got to keep to the market rate. We do have a fare benchmark in our salary rate, bonus rate, against other banks. So the degree you are paying, what people can receive and employees can see is a fair remuneration package. It also includes share options and so on. Our bank is very kind to many of its employees and shareholders. In terms of keeping the team happy you need to do your best to provide leadership to the team and consistently intend to administer and organize people in the right way. And also I think the teams who are directly speaking to the customers are more experienced in a certain role. It is desirable from the bank's standpoint. Bank S in corporate relationship terms I think they have strong advantages because a lot of the directors have been within the bank for 15 or 20 years. There are many very experienced teams in that way. It does score points over other banks whose teams are less experienced. Maybe they are

experienced bankers but have not been part of the same corporate culture in the same period of time.

I think all banks have performance-related bonuses and we are no exception to that. So you are judging your teams and individuals on the achievement of their KPI (key performance indicators). Each of our directors has a KPI, the bottom line of performance, generally speaking, and achievement of new business, as a part of that. So, if they achieve their KPIs you can take it that they will be rewarded accordingly. They have a direct line of sight. The director has the ability to achieve what they need to achieve to get their bonus. If you have a good year and you did it last year, then they will get the satisfaction. Money is very important obviously, but they appreciate their organisation. You have a feeling that you are a part of that in which is successful. It continues to take a part in the market place. It is a circle, or it should be. They are very proud of being in Bank S. A lot of people have been in the bank for a long time. For myself it is two years; that is unusual for my peers have been in the bank for some length of time. It is quite unusual for the bank especially on the board. That's less unusual, I guess, in Scotland... Because traditionally in terms if job mobility, especially in London, people move banks fairly regularly. In the Scottish market place it is changing. There tends to not to be the same level of staff movement between banks, particularly on the relationship side because you do get ..., what you do find is that head hunters are seeking younger people who are working in a transactional way, such as acquisition finance, structure finance. Individual workers tend to be mobile, tend to prefer to move through banks, through jobs than those in the relationship banking area. It is very important to keep very good people. Without a good team you cannot get a good reputation for having good people.

We do carry out customer satisfaction surveys, customer satisfaction questionnaires, and carry out researches to seehow we are perceived by non-customers. So we can try to establish what we need to do to improve our market share. Not so much in Scotland but more in England we need to establish. How are we perceived by our non-customers, it's interesting to see that, how you are perceived as an international bank. Probably we are not so international compared with, in the English market, such as bank H. Obviously they have huge international operations. We have

operations in America, in a number of places in Europe, Amsterdam, Frankfurt and so on. We have an operation in Australia. We operate in the global market but the customer perceptions are not international at present. Because it's quite low compared to some others.

We measure customer satisfaction and we also measure the perception of companies who bank with our competitors. How we are perceived on the provision of services? We have electronic banking for example. It is very popular these days and so are hedging products. You have to provide proper corporate service to your customers. Not having a good product does not get you past the door but having a good product does not get in more accounts because, overall, all big banks have good electronic products. But we think we recently develop such as Internet and only two banks have relationship banking online.

Normally it is quite unlikely you are going to gain new connections by having the advantage in an Internet banking product in the market. You will gain some but I expect that you would loose connections if you did not have it. You will gain the connections by having it. So these things are important but not necessarily more helpful than having a position.

We measure each customer in terms of what we've delivered in terms of ROE, return on equity. We have a substantial focus on delivering bank products for each customer on an individual role basis. We go further than that. We call it RAROE -- risk adjusted return on equity. We work by a formula that takes into account a lot of experience in sectors of the economy, so if your are a manufacturing concern in a particular sector the bank will analyse bad debt experience in that sector. We will apply that experience to the formula by which we calculate the RAROE so that you can maybe start with a ROE of 25 percent but the RAROE might be 10 percent because of the loss driven by a fault. It is a substantial part of the loan.

In some sectors, such as property for example, you have got the security over the property asset. The loss of the default is small because you have the asset to back the loan. In a computer company, for example, if the loan goes bad, you tend to loose 90

percent of the loan. So we focus on RAROE rather than focus on ROE. RAROE is going to deliver to the bank profitability because as a bank we incur bad debt. It is inevitable if you are in the lending market. It is inevitable to incur bad debt. If you do not incur bad debt, you are not doing your job properly because you are closing out opportunities which come along if you are only focusing on those accounts that you know are safe. You are not doing your job properly because you are taking out opportunities and not correctly calculating the risk.

But sometime we need to take the risk. That's why relationship banking is expected to be less risky, to lend to someone you've known for 20 years, than someone just coming straight in with a new idea.

Interview with Mr M a relationship manager in Bank S, at C Offices, 150 F Street, City M, between 2 and 3pm.Email, tel: mob: fax:

G: I have these broad questions. Please feel free to speak about anything, as you wish.
M: I think it would be better to take it as a market rather than in a particular bank. Generally throughout the banking market, the customer is a source of profitability and banks exist to make returns to share holders, to do that for growth. In the regulatory market, capital can be quite constrained if you lend too much money. Banking is not just about making loans, but also delivering more value, cross-selling more products to the same customer. And you can see across the whole of the market, in banks they are traditionally maybe seen as lending banks, but they are diversifying to related financial activities.

The reason why banks try to establish long-term relationships is because of the nature of profitability, the customer relationship is linked to the number of products and services you've delivered to your customer and the length of time you have had the relationship with that customer. Because banking is purely about relationships, the longer you have a relationship with a customer at a high level, the easier it should be to increase sales to that customer. It will be best to identify their needs and requirements and match that with your products and services which you have available in your own range. And the second point is quite technical, as to open an

account and service, a relationship, with the customer, the reason is the cost involved which decreases with time. If you take for example, a person who simply opens an account, the cost of opening that account might be equivalent to what you may earn from the account for the next three years. So like any business when they start up, the new customer of the bank is more like the new business of the bank, the bank will make a lot of money out of certain accounts over the further three years of their life. Beyond that, the bank will start to make a return from that product. That is where the long-term relationship is expected to come in. It is quite important that because it is about shareholder value or shareholder return, the driver of the profitability the driver of the bank. The bank needs to maintain profitable relationships because the bank's business and any other business needs to make a profit and need to grow. That would be where the long-term relationship comes in.

As regards the corporate customers, it would perhaps be useful if you explain to me what you understand about corporate customers. That's large companies. That's a large range of businesses. The relationships with corporate customers are very important for a variety of reasons. As I just mentioned to you about profitability, corporate customers tend to pass a volume of services and products, the volume of transmission, the volume of processing, the volume of products and the bank is very clever at dealing with that volume. In having a lot of small customers, the bank needs to aggregate some transactions to deal with on a volume basis. If you then have long, large connections you then have a relationship with them. They have a volume need for services but they are as easily as you can to serve the smaller customers. Obviously you do not have a point to maintain. In terms of smaller business banking-type activities, you might have several thousands of connections that will create the same volume. On an economy of scale basis, large corporate customers with volume products, volume service requirements, are very expected. In terms of internal trust, in banks, they have to make a similar, not the same, return.

Obviously the corporate customers are very clever and they know that they are long life. They never had bad debt. Banks like other business have a fixed overhead and fixed overhead on most of the products and transactional businesses. The long overhead is mainly to do with maintaining the customer such as the skilled people

you have. The variable depends on the number of connections you have. And obviously looking at the corporate market you do not need much variable overhead because the number of connections will be less. In addition, the corporate customer tends to participate in more complicated transactions, more complicated products, more complicated services. And Bank S as an entity has built a successful corporate bank on its capability to deliver complicated and sometimes very complicated solution to large corporate customers. Our potential competitors do not have an appetite to do so. It is a very small niche player in a large corporate market.

In addition, in terms of corporate customers, they are very good advocates for the bank. Traditionally having large corporate customers or banking with large corporations will bring ancillary business, because the large corporations are visible in the market place. Their cheques come from large corporations, their payment from large corporations, our services users, the large corporations, they are visible to the lower level of economies that stand beneath. So the smaller business, the individuals they are a way of marketing the bank, if you like. For example, if a large multinational uses Bank S, there must be good services, good products, or good delivery for the multinational to use them. Smaller businesses or individuals will consider Bank S as their linkage.

How do we keep relationships with corporate customers? That's a more difficult question. However the answer to the question is actually in the question itself. It is a relationship between people. It is a relationship particularly with corporate customers. We are experienced professionals in maintaining relationships or retaining relationships with corporate customers.

It is not necessarily about price I think. Being the cheapest is not necessary to win a customer or retain one. Being the best at what you do or delivering what you say you would deliver and delivering it quickly, efficiently or effectively can be a measure of success. In my personal experience, pricing can be competitive, but corporates require delivery. Even if you are the cheapest, if you fail to deliver then there is no future. Equally if you deliver you do not have to be the cheapest, providing you are competitive. It is always a value perception, a value-for-money perception, and a

quality of service perception. That's very much of concern to the experience of the professional individuals who serve the customers. So how do we keep relationships with corporate customers? Perhaps there is no simple formula if you expect y=z for your keeping the customer. It is all about relationships. And many of the large corporate clients of the bank have been customers for quite some time. If you ask them why they remain as our customers, it may not be because we are the cheapest one, I would venture to say, but because we do what we would do. Or we continue to improve, to develop their business. We do that quickly, effectively and efficiently and in a manner to suit them. Things come to us early about the potential service and products. So the bank still has the appetite to move into markets where we will potentially invest in equity for example, as well as providing debt. That's because of its role with customers. It's almost a partnership, so every customer is a partner of the bank. It is a partnership together. One thing is clear is that if the relationship you have with the corporations allows them to be successful that makes a successful relationship. Their business growth is a source of yours. So how do you keep the relationship with your customers? You mainly focus on maintaining relationships, being close to the business, understanding the business, needing the direction to be able to assist the business potentially. We explore a certain type of business with those customers in growth or expansion. If we are with their businesses, we almost have every side of the way, in the sense of quite simple, quite high level. That's really what it's about from my perspective.

How to organize and compensate the relationship managers? I would like to answer how does relationship banking impact the bank's performance first because it follows that point. In terms of why banks are maintaining corporate customers and maintaining long-term profitable relationships, because every business is trying to make a profit for shareholders. How does it affect the bank's performance? For example, to look at the question from a different way, nobody survives without customers. Banks want to establish long-term relationships and keep long-term relationships with customers. Customers are central to the banks. They deliver everything. You can be very customer focused, in terms of running any organization, and banks are not an exception. Coffee is a crucial part of Nestle. The Coffee Company needs to sell products and make income and incur costs. Without a

customer base you will not able to deliver that long-term. For a long-term strategy, this is why banks potentially, cross the whole thing, want to treat themselves in terms of making long-term profitability. Some assets can be seen as growth targets. In terms of long-term business, such as making long-term loans, it may not be profitable immediately. Over the long-term, these banking activities, however, they will deliver a running yield year-on-year. A ten-year loan will make a profit every year or income every year in fee-type businesses. It will deliver profits this year or next year, after this you need to replace it with new business and so on and so forth. However in terms of relationship banking in Bank S, you can not be in either fee-charge business or long-term driven businesses without the customers in the first wave. So before you decide which strategy you will go for you need the customers.

It is very much easier to keep a customer than get a new one. So the balance tends to be to keep the customers you have and grow or bring new customers. But they may be mixed. You have a rolling yields profit. Then year-on-year profitability, from interest income for example, comes to you year on year. But also you try to attract fee and charge businesses to the rolling yields profit one.

Relationship banking affects a banks' performance. If you look at any bank, no matter where you report the profits, they very much come from the same group of customers. On the relationships, you will have anywhere between five and nine products, some of the products will be on the asset base, some will be on the liability base, others will be on fee-driven products. In terms of volume-based businesses, such as money transmission, international trade services and activity and so on and so forth, they really make sense. But in terms of the UK market and corporate business market, it does not financially apply within the UK. So relationship is a fundamental concept for bank activity. What you may see when you look through the annual reports of different financial institutions is they will report their profits, and their asset and liabilities, or the other income under different headings. All these come from the same numbers of businesses and customers. So relationship banking does affect banking performance, if you have not got the customer in the first wave, it is difficult to be able to decide what you go for, for running new business or annual pay business. In any event, you need a combination of both because the shareholder is

looking for short-term profit and medium and long-term return. You need a stable growth model, and you need to deliver the needs from the top.

How do you measure relationship-banking performance? I will leave this question to the end. Relationship banking probably has very much to do with profitability, and a rolling yield. That also is a key measure within every business these days, return on equity, because of the shareholders, and banks are no different in that. In terms of banking performance, we do measure the performance in terms of profit and loss, assets. We measure costs, we also measure return on equity. We also measure what we call risk adjusted return on equity [RAROE], calculate return on equity, because different product types have different capital requirements. In addition, we also adjust them based on the risk profile of the connections, the customers that you're lending to. Banking is really about risk and reward. You measure risk and your reward should match. If you take a high risk you should have a high reward. If you take a lower risk then your reward will be lower. That's how the balance works. The risk adjusted return on equity model just reflects that balance. If you are lending an asset to a double A rated company or triple A rated company, you would not normally yield the same margin. The list would be triple A corporations, double A corporations then small companies. The risk adjusted return on equity model allows you to recalculate the return based on how you use your capital to do that. That's the theory of the mechanism. That's how relationship banking is measured. The key component of the measurement is growth. It can be asset growth, profitability growth. These are the key measurements in terms of the performance.

Whether you measure market share? Yes, it can be a useful measure. However the question is, if it is important, that you could have a lot of customers. If you could potentially keep the market share, you have a great deal to make the return you require from each of the customers. Therefore, over the short and medium-term or long-term, you will aggregate shareholder value.

It is all about the efficiency and effectiveness of capital to deliver maximum profitability and growth not just on an annual basis but also on a rolling yield basis, a year-on-year basis. You want to get stable returns and growth at the same time. It is

what every bank is trying to do. There are many different ways to achieve that. However I think that's the goal that most financial institutions need, to grow stably and deliver profits to shareholders.

How do banks organize and compensate relationship managers? We have within our organization a structure of separate teams that undertake origination and relationship management. The two things work very closely. However most of our teams, they are teams on separate activities. So origination is bringing new customers, or new projects, new profit to the bank and executing those. And on the relationship management side once they are executed or the customer has been brought into the bank, then the day-to-day management is ongoing and future management will be taken by a dedicated team. So they separate most sale or marketing activities from ongoing service activities. It is not that clear to be fair, because as a part of the ongoing relationship management activities, customers need to change the business to grow, to diversify, to merge, so the relationship managers also have elements of new business, identifying needs and matching needs to services and products as well as service execution. So the identification and match patterns are origination during the relationship management that's our most basic process, which motivates and delivers the services and products to customers. Then there are a lot of day-to-day activities: managing the relationship, doing things like money transmission, and so on and so forth. That's a time series, similar to, other types of service activities, as part of the circle, we will go round, round and round, hopefully as long as you keep the connection, which will be forever. Even as our business changes and growth develops, it is always identifying and matching, fulfilling the products and services, and developing new services and products and so on.

And that's not necessarily a product or service within your business area. It could be anything that the bank can offer. The right groups and the services around are very much serving that end. It's not the idea to get one customer but the cycle is continuing. If the number of products and the number of services which customers have increase, we call that ... we deepen the relationships and improve the profitability.

In terms of organizing and compensating relationship mangers, they are organized and compensated to do that. They are valued in terms of bringing customers, including profitable customers, crediting to risk customers, at the right price, with the right products, from their own particular products and anyone within our group. Those products and services are provided to customers by the most appropriate teams. But the important thing is that customers expect that the bank is an organization. Origination managers are incentivised from the customer perspective. At Bank S, our relationship managers are the main profit points, behind that, maybe supported by several business teams within the group. But as far as our customers are concerned, they want one point [of contact] in the front side. Over the years they will have their relationship managers, essentially, if it is not a special product or service, for example, treasury products they may have a relationship manager, but they will also go to the counter of a Bank S's branch and it will be a one-stop shop, which is the way that the banks organize the relationship managers.

How are they compensated? So, targets, profile target, own product line target, profitability target, some growth targets... there is a lot of targeting identification, and our bonus streams, and measures to incentivise our people, and payment made for that. In the same way there are many businesses that have to deal with in terms of service quality and sales. We will incentivise the people in a certain way. Services tend to be a very qualitative measure. And the sales element may be set against not only qualitative but quantitative measures, so we develop both. Where the bank is very cautious is in terms of risk, because our product is risk. It is not if you are selling boxes. Because if you are selling boxes you know about boxes, you know what the function will be and the box is sold and very little goes on around the box. But your product is risk. You incentivise people to sell risk. It is in their, almost in their, interest to take on credit services. So one point is that we will carry on to incentivise and compensate and organize our people. Yes, we have people who are incentivised. They are very careful of both measures. But behind that, because our main product is risk, the reward and analysis, the risk profile is actually suitable for a bank. In terms of incentivising the origination, to bring new business, equally with relationship managing existing business, it is the same rule: if you like applying risk, you should make the profile acceptable, should price it correctly. For example historically, in

most pensions selling, it is on the position that you are selling the same in the market. Let's put an example. We tend to use a bonus when your key product is risk. Because you won't necessarily incentivise people selling risk. If you want to incentivise people to sell things, you will need necessarily to make them sell the right things to the right people. And one thing to any bank is that the customer gets the right products, not just what you think they should have, or indeed what you want to sell to them.

It is all about identification and matching. They [products or services] have got to be appropriate to the customer, not necessarily appropriate to the bank. But at the end of the day I will come back to my earliest point which is without customers, profitability and stable growth will be impossible. You need time to meet the customers, to know the customers' requirements and needs, and services in an appropriate way. That's obviously going to keep the relationship with the corporate customer, and keep the long-term relationship, so the organization and compensation are very much linked to the retention of good and maintaining of good quality customers. It is only about the right products and matching the right products and services with the right customers' needs and risks, and pricing the profile. For a long-term relationship, we want a long-term benefit to the customer and also to the bank because the products do need to benefit both. You need a balance between these two.

There are about four pillars to relationship banking, or the stakeholder pillars, in which the shareholders are included. There is also the pure customer pillar, then you've got the employee pillar, then you've got the financial side. I expect that, if you draw a square, your perfect right is absolutely in the center, however market forces will allow the point to move constantly. However, we should not leave ourselves too far away from the center. Whatever we draw, a triangle, or a square, we need to be at the mid point. But the more important thing that I just mentioned the importance of the customer, because customers deliver everything to our stakeholders or any shareholder value.

It is very different and the only thing that differentiates one bank from another are the people, because the relationship business is a service business, and the products are

very simple. Money is available everywhere, and particularly when you're going to a market where pricing is not necessarily a determining factor, the people who are around the business, delivering the business are absolutely key to that. How banks develop and train and add value to their own workforce, and how they manage that in balancing off market pressures, the changing new economy, shareholder expectation - - because the shareholder expectation tends to be that costs be reduced... Now in most banks, most business, the largest costs tend to be the people. However within banking people are fundamental to delivering products and services. The knowledge people hold is the most important asset of any bank. You have to use high quality employees, with all of the available tools and skills and resources, to provide the best possible services. We need to have a balance of cost, a balance of customer expectations, customer requirements, and customer values.

I think in the triangle the business stands, these three things are incredibly interlinked and important. They do not exist in a vacuum. There is a wide world that continues around the way the economy, society will change and shape itself today and in the future. The three parts, shareholder, customer and employee, and the balance will constantly move. Anybody will lose in the context ... for example, going back historically to the individual industries within the UK economy, which had a hard time ... in another, for example, the late 1990's property market potentially had some difficulties.

There is a shareholder perception about issues, or stakeholder perception about issues, a customer perception about issues, employee perception about issues. If you go back to one and a half or two years ago, the property market was in a different position, was very profitable, very buoyant. Again, then the shareholder perception, the employee perception and customer perception, will be different. When you talk about the three areas, there is a context they need to be put in there, the wider economy. The one thing is that banks are often criticised. Banks will give you an umbrella and take it away when it starts raining. Which is basically fair that the bankers are criticized for being in the lending money or banking businesses. When they particularly say they are not doing well, we will abandon some sectors to protect shareholder value. And the way we abandon the sectors by communicating to employees in terms of

creditability, and so on and so forth. We say people in a way that not necessarily and truly improves customer value. I certainly believe that there are good businesses in bad sectors.

If you understand the risk, and you measure their risk profile, and then you structure products or you have products, and the correct reward profile, then they come to you from every sector to open businesses with you. They are delivering long-term returns to shareholders and also the value of employees in terms of long-term benefits. The economy goes in a cycle and individuals have a cycle of their own. If you concentrate on these sectors, when the cycle is tough or the cycle is not good, they cannot deliver long-term shareholder value. It is very difficult to deliver long-term customer value, because they may stay in the market, may stay out the market, and our employees may need expertise in the market, or knowledge in the market. If you are really thinking of rolling out the market they may have the job or they may not have. It does not necessarily answer any of these three stakeholders, although there is a concept behind that. Each of these three values or three points need to be expanded, need to go wider. You may count four.

For the nature of bank-corporate relations, from my point of view, it is a people business. In any business where people buy things from people, IT (information technology) contributes to a people business, primarily by searching for prospective customers for the banks. There is a person, representing their organization, or a representative of the bank, speaking to the representative of the company. So the answer probably is both. The decision-maker on one side will decide whether to adopt the company's products or services, based on the relationship. You have the reputation. What does matter is our brand. If you have whatever brand the company is interacting with and those two brands will interact with each other. But that is through people. It is a person-to-person business based on people's relationships; banks are so dependant on having good people, mixing the right people with the right skills.

Because of technology, which would be used in a wide and broad way, relationship banking is more about delivery and the quality of delivery. In terms of technology and technology stream, things like direct banking, the typical channel might be

Internet banking, or specialist electronic banking systems. However, they are still sold on a people-to-people basis and time-to-time basis.

When companies take the first time to our services, they do so because they trust in the person in front of them. They say that they will do what you need. It will be delivered and they [customers] will continue their service requirements. No matter what you do it is a people to people business. There are some relationship levels, even the chief executives of the company levels; they are potentially highly rewarded in the organization. There are many human relationships. It all goes back to that, it is a people-to-people business.

G: Do you meet the customer quite often?
M: Yes, personal relationships require feeding, if that's the best word. And they require nourishment if you want to grow, so yes, we regularly contact with the customer. With large corporations, the relationships may be much closer because the portfolios of large corporate customers tend to be much smaller. So the relationship manager might have ten to fifteen large corporate connections whereas the smaller end of the business market might have two hundred connections. They will make regular contacts with customers, ten or even twenty times a year, a bigger number than with smaller customers. They're different.

But the management business will be the same because every bank needs regular customer contact because you need to understand your customer and match your primary products. You need to understand what is happening in their business. If you are not close it may not be easy to do. The best way is to make contact with them often. So if you want to do any more selling and maintain your performance, you need to be close to know when the business changes and what may be happening. That will allow you to assist their business and deliver value in providing the relevant product at the right time for the right price. So it is a regular contact. In our group the relationship managers have a certain level of contact over a year, and it very much depends on the size of the relationship service. It is not the bank forcing the people to do it. They do it naturally because it is a people-to-people business; therefore they maintain their business with regular dialogue, with regular contact.

When you start your banking career you are always told the best thing to do to get around the business is to kick the tyres. When you buy a second-hand car you are going to certainly kick the tier, and make sure it does what it's supposed to do. Bankers or corporate bankers do exactly the same thing on a regular basis. So looking around it, kicking the tyres, checking the bodywork, you will see if something may be helpful.

G: Do you think you can get enough information from your customers? Maybe they will tell you their future plans or something like that and that kind of information cannot be found in the public arena.

M: Yes, there are a lot of regulations that apply regarding the company's confidentiality. But also if you are dealing with purely public listed companies, you need to be careful about the information, because there is a lot of information which could be shared between the organizations, because there is lot of market sensitive information. However, every bank, they have a company confidentiality agreement. A Chinese wall will be put in place to segregate certain activities from wider relationship banking activities. So banks will be appealed and therefore they have to quit from that if the information is sensitive. Again there are also certain sorts of organization that test the requirements and maybe put them away from some activities.

They require certain types of information frequently and that again helps. The problem is that there are no substitutes for regular dialogue to get close to the customer and understand what is happening. Because in a regular dialogue the customers might be mentioning and thinking and planning something and want to discuss what is happening. The relationship managers potentially share knowledge about what may happen, what they might experience. Therefore the whole value behind the relationship with the individual is not just a one-way exchange of information. It's a two-way exchange of information. We also provide information to customers about external bodies or industry bodies, and so on and so forth, such as

external information about expansion overseas, trade with overseas, and so on and so forth.

They need, what we call, a dialogue with the customers. The one thing is that banking needs a number of customers. Customers are running their own business. Banking is just one part of their business, and usually a small part of their business. A manufacturer is not a banker; he is a manufacturer or she is a manufacturer. What a bank needs to be very careful about is that banking is one part of their business activity. However if we understand the rest of their activities, we do not necessarily assist with that, we can have input to that, and we are able to provide our products to be relevant to that. And, that will assist our customer in doing their business. We deliver value to them, and in return, we get a lot. This is a fair exchange. So that regular information is a requirement, so is sensitive and constructive information in certain ways. There is no substitute for being close to the customer.

G: Do you have any problems or challenges currently in doing corporate banking?
G: It is always a challenge. The challenge is that every bank wants to grow. Banks cannot be growing with the economy. In the stock market, in a new business market, you can do it with economic growth. In terms of your own business, your own bank, the easiest way to grow is to keep the existing customers, and get new ones. In getting new ones, because it is only a finite market, if you want to get new ones, you need to steal someone from somebody else. Every bank undoubtedly competes with each other. The most successful organization gains more customers than it loses. And very successful organization won't lose customers. They want to gain customers. They want to do any business in every bank's portfolios.

If you ask about their customer base, they have some customers, some of them are about the best above all the others; a big chunk in the middle are good customers; and some customers are that I do not mind, and there are potentially, probably more difficult customers. So every bank has a challenge to increase its shareholder return and increase stakeholder return by growth of the customer base. Growing the number of products and services provided to our customers cannot give customers what they need. You should definitely not give customer what they do not need. But you should

give them the appropriate products at the appropriate pricing, at the right time. Then you need to maintain your customers. The challenge is, you've got to say, the approach to maintaining the customers of the bank, and not necessarily, but an approach to acquiring the customers that other banks still want. In addition to approaching customer and attracting customers, banks do want to keep customers. But we have some types of customers we do not want to keep.

The challenge is that not every organization has healthy competition in the market place. And that's why pricing is the main driver not the customer retention. You need new customers. It is a fact because you do have competitive services; you do provide the product. Even if there are some brand new products that nobody else does, it is a very small window you have. Anybody else can capture it. So in banking, competitive advantage is very difficult. It is a challenge that it does not last very long, but with the exception of the people that you have in your organization. That can be your competitive advantage. Within Bank S, our people probably are our competitive advantage, and most products we provide can be provided in the UK. There are a couple of niche activities, let's say we engage in, we are more engage in, we provide all services and products. They are probably not known for them, but we are. Generally when we talk about the mainstay of banking, there is very little, now, we pay attention to our people.

The challenge to banks is keeping the equilibrium between the three, and keeping contact with the rest of the world. Equally it is maintaining the best customers, we must attract them and maintain them; and maintaining the best employees; and together with the best customers, we will deliver shareholder value.

Interview with Mr. J, the director of Corporate Banking in Bank S, in city B on 24th July 2002 at 10am the Nth floor, Number S Street, City B, Post Code, Email: Tel: Mob: Fax:

In corporate banking, there are a number of areas. First of all, we should think of corporate banking particularly in terms of relationship banking, the relationships

between the bank and corporate customers. Here, we look after about x corporate connections. We classify these as companies with a turnover of more than x million. These companies have a turnover of more than x million pounds and general debt of more than x million. We have been lending about x billion tending to go down to x billion. We have x directors who are working for me and some support teams, they look after their portfolio. I think the challenge at the moment is two things: the generation of new business and the active control in management of the existing corporate lending. We have a fairly vibrant book. We cover almost every sector. For instance, we bank with a number of Scottish PLCs and English PLCs, a lot of companies in manufacturing, a lot of property companies, the traditional Scottish industries, such as paper and whisky. We bank with a number of Scotland's high profile entrepreneurs. It is a fairly mixed portfolio, which has ups and downs. The majority of the new business is currently in the property market. Retail and commercial property is hot. The bank has lent a lot of money because of the difference between property use and the interest rate and won good opportunities to do some good deals there. The dangerous challenge in the property market is: "Will the bank be guilty of over heating the market by the amount of money being put into the property sector?" The second issue in new business is, as a part of our businesses, if we take deals over the last five years as a leading player, in the UK the venture capital community, the private equity market, now the private capital market in Scotland is very quiet at the moment. We have been the leading player and have had some difficulties in technology. We have closed one office in A and B.

We have many difficulties with manufacturing companies. What has happened is three or four years ago, because the venture capital community was flush with cash and the competitive element in the banking market, the prices paid for certain

business was too high and the stock was too stretched. The investment and services companies will probably be OK, but the venture capital community are scrambling around being beaten. But the front expectation is still too high and also being beaten by buyers. Where can we find our next new customer or next buyer opportunity taking account of the lessons from the decline during the last few years? The big and main challenge is making sure we do not lose money on our existing lending book. We have got a number of customers who want to make acquisitions because the private equity community is very very quiet. We are of course banking trade buyers; our customers are trade buyers. Therefore we want to do these things. And we will just follow these relations; it is all about following relationships, whether in England, whether overseas or wherever.

But with current economic conditions the expected interest rate is low. We made deals three or four years ago and we are having some difficulties and I'll go back to this point later. A management team says we want to buy this business and we need your funding. The vendor's expectation is very high and a lot of money is needed at this time. Investment companies or other venture capital houses may answer them. We say, well if you do not put in money in this business the Bank S will do it, and visa-versa. The competitive environment is always stretched. However, for the buying companies, if the price is paid too high and the debt and equity structure will be based on this project, they expect that the sales are going to increase and the management team will be in growth. But if that does not happen. The management team or group cannot increase sales and other businesses. And it does matter how a good management team they are, if the debt to equity is too high, it is very difficult to keep going.

We look at it if companies have difficulties, we have a choice: we can call off or reconstruct the structure. If we call off we will lose a lot of money. Or we do a restructure. The restructure is prevented in venture capital houses. We will do the debt-equity swap and even put money into new management. So we can hopefully provide the best return to our bank and at end of the day we save their jobs and possibly create them money. But the big problem at the moment is the difficulties; we have to stop businesses failing. It depends on the facts but we prefer to do a

restructure rather than go for insolvency. The challenges are making sure that the businesses we stay with are have a nice structure and then we can go forward to new business opportunities. We must make sure that the management teams are correct. Management, management, management, every time we do the management.

We have got the ability because we have accounting diligences and environmental diligences, and we have legal diligences. At the end of the day the management team, which we've found their business was in difficulties. We will have a report, from one of the big four accountants, we will get the report; we will get the management accounting report. It will tell us whether we are able to recover the scenario. I can work that out by myself. Actually we are sending someone who we trust to say there is no link between your sales and production. If we do not tell them and they do not reconstruct it seems that you waste your time and waste your money. We put money in that company so that the operating level of the company is OK. We do a debt-equity swap in this company and it is OK. But in another company it is not. You need to think a lot. If we do not get an accounting report, we've got to make sure what is happening.

If you asked the question three years ago "what was the biggest challenge?" the biggest challenge probably was to win against the competition. Each of those banks are good at relationship banking and acquisition finance and a lot of products. Five years ago there were more banks offering more products. Now we have joint venture products, we have integrated finance, debt finance; we have relationship banking and a lot of things. I do not see the competition now because we have relationships with our clients. I do not think the competition is a real issue now. Actually we are keeping the existing business stable although in the meantime we have some difficulties particularly in manufacturing companies, because manufacturing companies, particularly, have worse leverage, and they have a big amount of debt. Manufacturing companies have got difficulties with cheap labour in other parts of the world. They have got difficulties if perhaps they were trading in Euros. Well in my view this summer will be the time. When we go to Portugal and Spain or France wherever we are we do it in Euros. We realise this thing exists. In the UK in general we still use the pound; it's still about control of the economy and there are a lot issues related to

the Euro. A lot of companies are dealing with Euros like manufacturing companies. We also assume that manufacturing companies will trade in Euros with companies in France and Spain. So there are a lot of issues related to keeping those businesses on track.

And the other thing is making sure the bank is continuing to develop new products and new business models, what are called, for example in the property market we have got, joint venture products. We will be dealing with 50 million pounds in property. We select the clients that we know have had an excellent credit record for a long time. We trust them. We put them at senior debt level and put them at the equity stage. There is a premium price for lending. They give us some return because they are sharing the risk with us. We've got to keep going on developing products and putting them into the market. We've got to keep looking at what our customers need and how we react to that.

G: As you mentioned you develop long-term relationships with our customers. You think the relationship is very important for corporate banking. How do you establish these relationships?

J: Some customers have banked with us for obviously hundreds of years. Some people have banked with us for two years. Some companies have banked with us for hundreds of years. We do not change our directors of corporate banking very much. Our eight directors have got a lot of experience between them and they have been in the job for some time, in ongoing relationships, on a personal basis, possibly three or five years. But there are two issues. One is the general culture. In Bank S, in relationship banking, we insist on a kind attitude to trying to help customers, and a supportive attitude in the event of difficulties because of relationships. If my directors move to another part of the bank, I will be able to put in another director in the same position and therefore when our customers have difficulties the attitude will still be the same. What we are going to make sure is our directors are close to the customers. Now the most complicated relationship is the managing director with the financial director or the chief executive with the financial director.

Interestingly enough we are different from venture capital houses in which the main relationship is the chairman of the bank with the chief executive of the company. We do not go to chief executives. What we are going to make sure is the directors do not just know the chief executive and financial director. They know the sales director and the marketing director and production director and operations director. It depends on the facts of the company. If the company is spread over a number of locations you know who is in charge of the operation in Dundee or Manchester, so there is a multi-layer relationship between my directors and our customer so we know about the strengths of the management team; we know about the succession issues in the business; we fully understand what the opportunities are to that business. And so our directors need to be close. They do not just visit once a year. They have an ongoing programme of visiting our customers and their premises. It should not to be a surprise to us if our customers come to see us to say I want to spend 5 million pounds on our production line. We should already know they are thinking of that. Or they want to make an acquisition in Europe or America. We should know that. Or they've just lost their order. Or there will be future financial governance. Because we are so close to it that these things should not come to us as a surprise. Because we should have discussed these issues and I can make an appointment. If I am going to other meetings I choose or request my directors to discuss with them about these issues.

In most of these meetings there is an opportunity on offer. I will join a customer for lunch -- that has been my job for three years with our customer connections. When I go there I do not want to discuss the prices or the facilities. I do not want to discuss financial governance. What I want to know is "what is your business about?" I want to meet their various teams. When my directors are out of here, maybe next week or next year, I want the relations with this company working. When the customer has a capital requirement, or other requirement, opportunities and difficulties, I have actually got knowledge of their business, so it helps me to make a decision.

The relationships are monitored by my directors. They establish relationships and they know their customers. We have a wide mixed portfolio; we have relationships with a lot of different companies. The directors are able to look after some customers in a particular sector because of their experience. They should know what is the

margin on that particular sector. They should know what the difficulties are. And we also do a lot of cross-relationship business from your point of view. We can introduce our customer base to people: they may be interested in people such as lawyers and accountants. If the companies could come, for example, we introduce yourself [the interviewer], we held or we called a China dinner, because what I realised is we have a company which has operations in China. We also bank on the world market. The directors of the world market are looking at opening in China. And we've got a number of customers who have operations in China. So we held a Chinese dinner; we shared a Chinese meal and had a Chinese affair. And we invited a number of people who did not know each other but they all bank with us, on a round table to discuss issues. So we do that sort of thing. We do business with another sector whether it is a street sector or a property sector. We mix up our customers and we invite them in for lunch. What we do is add value to them. Sometimes they do want to have lunch with their bank or have lunch with their lawyers. We had a situation recently, the people were mixed up, and we were at a debate. There was a principle of a college joining our lunch. They were running a course for one of our clients but they had never met before. It added value and we've got to do so.

When another one comes to the bank and knocks on the door, "Hi, we are back to bank with Bank S." We will reduce our margin, we will support them when the company wants to expand, and we will support the company when they have difficulties. They have close relationships with the directors who look after them. They have close relationships with the senior managers in Glasgow. We add value by putting them in a party where they come across a lot of businesses. People are there whether just for a chat or actually to create true businesses. We add value by people doing business together. That is all about relationship banking. There is quite a lot of effort to it.

And that's not like the retail market. Well I'll go to my computer to see the cheapest mortgage. There are a lot of places in that market. Because people are more switched on to price and different channels for distribution. People will switch. Corporate banking is completely different. Yes, you must have a channel of distribution, you must have all the products that anybody else has, and you must have the electronic

technology link, but the relationship is key, absolutely key. And then we get further deals from the introduction from existing sources as well because we are good at what we do.

G: You have got X directors in Bank S and they have established close relationships with their customers. Another question is how do you manage these relationship managers? How do you support their work? How do you measure their performance? How do you compensate them?

J: Each director has a team. Each director has minimum of one associate director, a corporate banking manager, and a corporate banking analyst. Some directors have two associate directors and some have two analysts. It depends on the size and complexity of their portfolio. So there are the teams there, in addition to a further support team, for operations etc. So the total team look after our corporate clients. It is about sixty with support, so each director has support.

And again, the relationship with the customer goes through the years. The managers will be speaking to people at their level of the organisation, or the financial controller, or whoever. Their work we measure by first of all their gross financial contribution which is based on margin and lending, and fees and commissions etc. So each director we have has a target budget for the year, and that will be measured as a monthly financial contribution. Second would be risk rating, deterioration or improvement. Each connection has a risk rating. If your risk rate is one you're just a superb company with no problems. If your risk rate is ten, you are in receivership. So we monitor the risk rating, deterioration and because say, a company was staying in the middle at 5, if that company now is straying toward 7, we call it is a higher risk. Now it is not the director's fault. But the monitoring of that company is performed by the management accounts and they are connected with the bank systems. So we can monitor the risk rating in terms of improvement or deterioration. It is a key measurement as well.

We also measure cross sales by referring to the other parts of the bank whether they are joint ventures, treasury, and integrated finance, or structured finance, whatever.

And we are also selling our corporate products. That's a measurement too. And also we will go down to the next contribution, which is debt provision, also how the relationship has been managed and also the creation of new business opportunities.

The related compensation is, we are just chasing this, that there is a core, obviously basic salary. And we are now changing the structure. There is a significant part now related to performance, which is the performance of corporate banking as a whole, performance of relationship banking in Scotland as a whole. And part of it is the performance of individuals. So they will set TPIs for the year and the weighting in connection with each TPI, and again be measured against that. Some of the performance is measured subjectively; some of it is relative to monthly figures. And this will be provided us. And bonuses, bonuses are also used to compensate our managers. You have opportunities to take in cash. Or another one, we will call "shares kicker", and each group will be provided with extra shares to help them. It is trying to get the employees to hold shares of the group. I think there is also compensation by providing greater working conditions. We have been in this office just about a couple of years, it is nice and bright, they all get new desks, they all get new computers, they all get a lot of space. There is a great environment for workers. So we plan that the facility is excellent and the working conditions really help us.

We provide a lot of financial products and services to these relationship customers. We will provide lending, we will provide deposit services, we will provide electronic cash management, and we will provide all sorts of insurance products, leasing products, and treasury. Again we will call the expert in the bank for a certain product. My directors' job is to know if it is treasury, who to call on and get the treasury person in front of the clients so that the proper explanation of all of our products, or any part of the banking product. [On the shelf] these are all the written down forms of corporate banking products. We also provide futures, swaps, etc. They are all done by treasury. I mean, for instance, we will be very kind to our corporate clients. We lock them in by selling them hedging interest rate risk because the interest rate is low and we have to get them to use it, let's just protect them.

Yes, there is a close link between our treasury team and our directors, and thereafter our clients. We will take an equity stake in selected customers. We take equity stakes and property deals. We will take equity in distressed companies. We will do debt-equity swaps. We will take it as a long-term asset like venture capital houses. We are not underwriting equity in this office. It is part of our business but the core part is lending money. But under a number of certain circumstances, we take equity because we want to provide everybody with a better return.

We design particular financial services for the relationship customers when they have specific demands. We have some new products such as our joint venture products. We have products from deposit to property, interest and finance. But we are the only one in the market doing business relative to shares, normally by venture capital houses. This has been designed to take account of customer demands, so yes, we are developing new products.

G: How do you benefit from these relationships?
J: Generally as our customers, they say we bank with Bank S, A bank for proper deals. Our customers refer. They provide us introductions to people they know. Our customers are a fairly vocal support, particularly in the high profile entrepreneur community such as Tom Hunter, Richard Emmanuel, and John Boreal. They will talk about Bank S. We are getting free marketing if you like. That happens because we are doing relationship banking. We are benefiting in that way. Because of the relationships we do extend our customer base. The second benefit is if our customer is a lot close with us than someone else, it is very often that our customers give us a big piece of their financial business so we get more business. If we see that a financial director or managing director moves to another company, he or she has got a relationship with us, they will introduce us to that company and therefore we gain a new customer. So we are retaining our core customers, you can see from that, because of these relationships, we've got opportunities to develop our relationships both on a corporate basis and an individual basis. This just starts again because the relationships have been established. These relationships provide us opportunities and we develop new products by discussing with our customers. And also we build the product infrastructure.

G: How do you measure relationship-banking performance?

J: We have a measurement of profit per customer and we use it often. We now have a measurement of return on equity --- that is risk-adjusted return on equity. And that is forced by all banks and we are really authorised now. We are able to calculate returns. We need to make money. What we are doing is using each group's capital and therefore we need to get returns. We've got to make sure of their margin, their needs, and any ancillary elements we get from the connections. And we look at the risk rate of those connections, and indeed the sector, which they are in. This provides us with a sufficient return. Now we are able to calculate risk-adjusted return on equity. If our deals are finely priced, we want to make money from this connection. So therefore like in the retail market, they do expect to sell goods or they will get losses.

So we have a risk-adjusted return on equity and we have other ways. We need to achieve our objectives; we are using each group's capital to make money for the bank. We also measure [the performance] based on the risk-adjusted model. We have a traffic light system relative to sectors, the red and green lights and their changes. You would classify telecoms, property, retail, and car dealerships in a green one at the moment. It means that it is OK. If for one customer or one sector, it is red, you've got to have an idea to improve it. You need another signal; you need go back to the normal process. And for these sectors, the traffic lights are rated depending on the economic conditions. If you change the customer base and that sector's rate also changes, we change the measurement from return to risk-adjusted equity because we are trying to look at the risk-adjusted proper return on equity and the probability of loss in the event of defaults. That is based on measuring risks. Banks are trying to record the risks of the sectors. So it becomes quite sophisticated.

G: Do you also calculate the future or the potential profits from customers?

J: Yes. We view the whole life of the loan and the potential default of the loan. We have files such as paper files and extended and large database. I can go into my computer and find out the records during a period of time. I can try out find out papers and correspondence related to each connection. We have records on how it

started, where it has been, where it is going. So someone could pick up, our directors, they can find the record particularly for the last credit. That paper [on the shelf], on the back at the end, has got the information about the connection: the nature of their trade, their risk assessment, comments on their management, comments on safety, comments on variability and they are generally easy understand, the documents in relation to each connection.

We also measure customer satisfaction, customer retention rate, and these kinds of statistical numbers. These are all done by independent survey. And other things we have done recently for selected customers were independent surveys which were carried out on customer satisfaction, customer relationships with directors, etc. But these were independent surveys prepared for the bank; it [data] is difficult to find out. Other publications such as Scottish Business Insider and newspapers do the surveys. Because any survey that has been done by banks is for the banks' own use. They will phone up the customers, ask questions, they will collect and put these results to the bank. We say we are relationship bankers. We are appointed to check out customer satisfaction. Actually we want to make sure that our customers are satisfied. We ask questions such as "When did the director last call on you? How do feel about your relationship manager? How close do you feel to these directors?" etc.

Web Materials

This section consists of web materials about corporate banking in bank S.

Corporate Banking has once again delivered a set of strong results with profit before tax and exceptional items up by 21% to £826m (2002 £681m) notwithstanding a challenging economic backdrop for much of the year. Our clear focus on controlled growth, improved returns and credit quality, together with our proven ability to create and maintain strong relationships with our ever growing list of customers continues to create significant and sustainable shareholder value.

Operating from 22 offices in the UK and 13 overseas, the markets in which Corporate Banking operates are large and diverse and have the potential to deliver sustainable profitable growth for many years to come. We provide a comprehensive and growing

range of products and services, predominantly to mid-market corporates, principally in the United Kingdom, but increasingly we are extending our core competencies to appropriate overseas markets. Internationally, we concentrate on niche areas where we have proven skills and a competitive edge, often seeking to partner with local banks. Our franchise now includes profitable activities in Europe, North America and Australia. To supplement our continental European representation, in October 2003 we opened an office in Antwerp, which operates as a satellite to our Amsterdam office. In North America, a recent initiative has been selective partnering with regional US banks on their larger customer transactions. This is a non-threatening, mutually beneficial approach to a real problem faced by these institutions as they attempt to compete with the larger indigenous banks.

We continue to lead the market in many areas. Our Structured Finance, Integrated Finance and Joint Venture offerings, often incorporating a "one stop" mix of mezzanine and equity in addition to traditional senior debt and working capital, continue to attract significant new volumes of business whilst at the same time optimising our return on capital. In the public/private partnership arena, we continue to work closely with the public sector in the provision of social and economic infrastructure. We also continue to build selectively our Project and Asset Finance activities, moving up the value chain when suitable opportunities arise.

We established a Client Acquisition and Development team to drive a focused client acquisition programme and in conjunction with Treasury Division, we have developed Capital Markets capability to support our key product offerings in the leverage and specialist finance markets and to further improves our overall client offering.

At Bank S, we solve these problems before they happen with one simple philosophy - relationship banking. Long-term relationships are central to the ethos of our Corporate Banking Division. With this strong relationship culture as our foundation, we can create innovative and individualised solutions to the often complex banking needs of our corporate customers. We keep our internal lines of communication as short as possible, to give you quick, constructive responses to your requirements. As

a customer you are assigned a skilled and experienced director who can handle your day to day banking requirements, as well as acting as a hub for any specialist services you may want to call on. We encourage a creative approach to problem-solving and by working closely with you, your key Bank of Scotland contacts can build up a real knowledge and understanding of the unique aspects of your business and your markets.

As well as providing information on any specialist services required, your relationship director can advise on a full range of corporate banking products. With the support of your director, a suite of products tailored to suit your own particular financial requirements could be put in place.

Bank of S has established a reputation for excellence in corporate finance, offering a highly innovative range of specialist funding solutions. As the market leader in the provision of debt for management buy-outs for the last ten years, Bank of Scotland Structured Finance has a reputation for quick decision-making and structuring innovative and flexible funding packages. Our long-term commitment and consistent approach to the senior debt and mezzanine markets has earned the trust of clients in management buyout, buy-in and take-over situations across all industry sectors.

Building on our leading position in the buyout market we have launched Integrated Finance, an innovative funding solution focused on long term running yields rather than short to medium term equity appreciation. This new product offers a funding alternative for UK companies which can be applied to primary and secondary MBOs, expansion finance, acquisitions, public to privates, and partial exits/re-capitalisations. Bank S Joint Ventures form strategic alliances with key customers, taking active equity stakes of between 15% to 50% which may involve the appointment of directors to the board of the joint venture.

Our Project Finance teams are made up of industry experts with specific experience and expertise in telecoms, media, natural resources and power. Bank S Equity provides development and expansion capital to customers with a large UK or global market presence in return for a minority stake in the company. In addition,

development capital can be provided to later-stage technology companies usually on a co-invest basis with another institutional investor.

Bank S Infrastructure Finance is the UK's leading provider of funding solutions to the PFI/PPP market. We are active across a range of sectors, including health, education, transport, defence and corporate PFI, offering an "integrated product" which combines debt funding with risk capital investment.

With extensive experience of making limited partner investments in funds, our team's core activities focus on private equity houses, whilst considering other asset classes such as property and quoted funds. In addition to becoming an investor, we offer an extensive range of banking products tailored to the specific needs of private equity houses. Our Housing Finance team is one of the leading providers of debt to the social housing sector, made up of professionals with considerable experience of both social housing and private sector property projects. Bank S's Marine Finance team provides debt finance solutions to corporate clients operating in the marine sector. Together with the Leasing team from Structured Asset Finance, these highly experienced marine bankers provide a comprehensive product range to the marine market.

The Structured Asset Finance team has massive depth of expertise in providing specialised funding solutions for major assets both across the UK and globally. We publish details of some of our recent deals, which you can view by clicking on Completed Deals in the menu on the left of any page in this section. You can search for specific deal types that are of interest to you, or simply review a selection of our deals.

Annual Report and Accounts 2001

This section consists of information about corporate banking in Bank S from their annual reports.

A strategy to beat customer, colleague and shareholder expectations, it's a rare business indeed that delivers outstanding outcomes for all three-stakeholder groups. Our customers must be our greatest advocates our colleagues are central to our ambitions – they must be the most highly motivated in our industry our shareholders deserve growth – we will make sure it is quality growth. The creation of S is all about growth; delivered through a pro-competition strategy which genuinely aspires to deliver outstanding outcomes for each of our three stakeholder groups: customers, colleagues and investors.

Customer power

The battle for customers' hearts and minds, whether they're individuals, companies or intermediaries, has never been nearly so important as it is today. In so many areas our industry still evidences a failure of competition. But in due course those who manage their business in the belief that the customer won't vote with his feet or whose pricing maxim is to charge as much as they can get away with today, will fail. H accepts without question that to grow our relationships with customers, we have to deliver value, absolute transparency and quality service. And translating that into a customer stakeholder goal – quite simply our customers have to rate S as the best, since in the financial services market of the 21st century the real power is theirs.

An army of advocates Every time our customers make contact with any S business, at a branch, over the phone or via the web, they will instinctively compare us to the competition and make a judgement about us. Colleagues right across S have a massive say in that judgement. G M, Chief Executive, Corporate Banking, "Over the years we have gained an enviable reputation for innovation, flexibility, having a can-do attitude, and responding quickly. The opportunities are simply immense. Across the board capability."

Operating from 21 Corporate Banking locations in the UK and a further 12 overseas, we offer a full range of banking products and services to businesses with an annual turnover of more than £10m. In addition, we are involved in a wide range of specialist activities including acquisition finance. In particular we have significant experience in Management Buyouts where we have been the UK market leader by the number of

deals for the last 10 years. Operating from our offices in Paris, Frankfurt and Amsterdam, we are now also the market leader in Continental Europe. Our close links with the venture capital industry with investments in 81 funds further enhances and complements our activity in this area.

In our integrated finance offerings we provide a complete funding package for our customers, which includes mezzanine debt and equity in addition to more traditional senior debt and working capital facilities. In joint venture relationships we partner with many of our customers to provide them with an alternative way of growing their businesses. In project finance we have developed a truly global business particularly in the oil and gas and power transmission markets. And in housing finance we are the leading bank provider of funds to Registered Social Landlords operating in the social housing market. In the area of public private partnerships we partner with the Government to provide new hospital, school and infrastructure projects. In asset finance we are a leading provider of debt and leasing structures to companies operating in a wide range of sectors.

Our relationship driven, added value approach which we believe combines the innovation and creativity of an investment bank with the strengths of a traditional clearing bank has resulted in us becoming the Corporate Bank of choice for an ever-growing number of companies and intermediaries. Our can-do and flexible approach to business, the speed at which we move and the fact that we are not a fair-weather friend – we are there to help in bad times as well as good – has resulted in us seeing an ever-increasing volume of opportunities.

But in Corporate Banking size is still important, and the bigger and stronger balance sheet that the merger has created will undoubtedly allow us to lead and arrange more transactions and underwrite and hold larger positions than either B S or H could have done on their own. We have already seen clear evidence of this in the months since the merger and we remain confident that we can continue the strong growth we have experienced in recent years as well as delivering significant revenue synergies – even in today's uncertain markets. As we do so, however, it is important that we never lose sight of the approach that has made us successful so far. In the past we have tended to

shy away from the commodity end of the Corporate Banking market where it is difficult to develop a strong relationship, difficult to add value and difficult to generate an acceptable return for our shareholders. The merger will not change this. We will continue to pursue a relationship and partnership driven approach which has served us so well in the past and has led to us having an equity involvement in more than 1,000 UK companies.

Our performance

Corporate Banking has had another very successful year. Our lending commitments grew by 32% in the year to £58bn and loans actually drawn grew by 33% to £34.8bn with all areas of the Division performing well. In Scotland where we already bank a significant portion of the corporate sector, our business continued to show strong growth. In England and Wales our lending grew further as did our network of offices with Crawley, Nottingham and Liverpool being added to our list of locations. Overseas, our North American business had another excellent year with all our offices making a significant contribution and our European and Australian operations both delivering strong growth. Our income showed very strong growth in the year, increasing by 41% to £858m. Net interest income rose by 43% which was faster than the growth in our lending, reflecting an improvement in our overall net margin from 1.64% to 1.69%. Our non-interest income also showed strong growth, rising by 38% to £322m with increases being seen in fees, commissions and investment gains; the latter despite a less than favorable market for equity realizations.

Operating expenses before exceptional items rose by 28% largely as a result of our decision to significantly increase the number of our staff to ensure we were and are in a position to take advantage of the ever increasing number of business opportunities we are seeing, both in the UK and overseas. Although the increase in our expenses was significant, they grew in percentage terms far more slowly than our income, leading to yet a further improvement in our cost: income ratio, from 19.5% to 16.8%. Our profit before tax and exceptional items showed very strong growth in the year, increasing by 37% to £515m, notwithstanding the increase in provisions referred to below. This equates to 17% of the Group's profit before tax, exceptional items and Intelligent Finance, which was achieved with only 2% of the Group's staff.

The slowing economies in the UK and overseas inevitably resulted in some strain being seen in our lending book and as a consequence of this our charge to provisions against bad and doubtful debts increased in 2001 by £71m to £198m which equates to 0.65% of our average advances for the year. This compares with a figure of 0.58% the previous year. This relatively modest increase is we believe a very acceptable outcome at this stage of the economic cycle. Our non-performing assets at the year-end equaled 1.6% of our loans outstanding before securitisation. This compares with a figure of 1.1% at the end of 2000 and again, we consider this to be a very acceptable increase at what is a difficult time for many of our customers. Although 2001 has not been without its challenges, we believe that our very strong lending skills at the front end and our strategy of working with our customers to help them through a difficult period significantly reduces the actual losses we incur on problem credits.

Growth prospects

Our prospects are excellent. In Corporate Banking we are the clear market leaders in many of the areas in which they operated. The bigger and stronger balance sheet that S provides will allow us to build on that enviable position and grow even faster in the years ahead. Our reputation in the marketplace is excellent, and we have a highly talented and experienced staff that we believe is the best in the industry. We are looking forward to the year ahead with confidence.

Annual report 2002

Corporate Banking Controlled growth, improved efficiency and a dedicated focus on credit quality have delivered a 30% increase in profits. The markets in which Corporate Banking operates are large and diverse and have the potential to deliver strong sustainable growth. We provide a range of products and services, predominantly to an ever-growing number of mid-market corporates, principally in the United Kingdom, but also in appropriate overseas markets.

We continue to lead the market in many areas. Our Structured Finance, Integrated Finance and Joint Venture offerings, often incorporating a "one stop" mix of mezzanine and equity in addition to traditional senior debt and working capital,

continue to attract significant new volumes of business whilst at the same time optimizing return on capital. In the public/private partnership arena, we continue to work with the Government in the provision of a social and economic infrastructure. We are proud to have helped deliver over 160,000 new school places and over 7,000 new hospital beds. We continue to challenge, consolidate and redesign our back office operations to improve customer service, increase cross sales and drive down costs. Central to this is the ongoing rollout and development of best of breed systems solutions. 2002 saw the successful introduction of Core Banking System, our new real-time relationship banking system, whilst 2003 will see the delivery of our enhanced internet-enabled electronic banking platform.

Our Performance Corporate

Banking's proven ability to create innovative, customized and added value solutions, which help build and sustain long-term profitable relationships, through good times and bad, continues to deliver impressive results. Controlled growth, increased returns, improved efficiency and a dedicated focus on credit quality, have resulted in a profit before tax and exceptionals up 30% on the prior year, notwithstanding a challenging economic backdrop.

Financial Performance

Profit before tax and exceptionals grew strongly, increasing by 30% to £681m. Operating income advanced by 35% to £1,182m underpinned by a solid mix of increased activity across the existing customer base as well as a continued good flow of attractive new business. Net interest income rose by 35% compared to a 25% growth in lending, reflecting a further significant improvement in margins. The upward trend in lending margins evident since the beginning of 2001 has continued, with our overall net margin increasing from 1.69% to 1.83% over the last twelve months. Non-interest income also continued to grow strongly, up 34% to £445m, with significant increases in fees and commissions again well spread across all areas. Investment gains also picked up significantly in the second half, totalling £23m for the year. This was achieved in a difficult exit environment. Operating lease rental income also grew strongly to £56m, a direct reflection of the success of our asset finance operation. Operating expenses rose by 24% over the year albeit the rate of

growth slowed in the second half. Whilst we continue to recruit selectively, we now have in place the necessary staff and infrastructure to fully exploit the increased opportunities available to us. Encouragingly, expense growth was significantly slower than the rate of income growth, leading to yet a further improvement in the Division's cost/income ratio, down from 17.1% to 15.5%. Such cost efficiency is a cornerstone of our operating philosophy and will be maintained. We will exit markets where we cannot establish a competitive edge, reallocating resource to more remunerative areas.

The continuing economic slowdown has inevitably resulted in an increase in provisions. We do not consider this in any way unexpected or disappointing at this stage of the economic cycle. Whilst we cannot expect to be immune from the difficulties being seen in certain sectors, we have largely avoided the worst of the high profile corporate collapses seen in the last eighteen months. Indeed the five largest provisions amount to £60m. The provisioning profile is as follows:

• Total charge in 2002 was £295m, equivalent to 0.74% of average advances. This compares with £196m and 0.65% in 2001.

• Non-performing assets as a % of loans outstanding at December 2002 were 1.61%. Encouragingly, this represented a slight improvement over the 2001 equivalent position. Deposits grew by 23% to £14.1bn. Whilst the Division remains predominantly asset focused, dedicated Corporate deposit teams target this important element of the funding mix utilizing a range of specialized products combining competitive rates, ease of use and service excellence. A key focus in 2003 will be to improve our self-funding ratio. Merger synergy benefits continue to run well ahead of expectations. The Division's post tax return on equity has also been disclosed for the first time. The increase from 17.8% to 19.4% clearly shows that it is possible to make excellent returns from Corporate Banking, even in tough times when provisions are at a higher level than the through-the-cycle average.

Prospects

We expect the positive trends evident in 2002 in terms of controlled growth, improved returns and increased efficiency to continue in 2003 and we will continue to focus sharply on credit quality whilst not losing sight of the opportunities, which are available to us. Our reputation is excellent and we have a highly talented and

experienced group of colleagues focused on the return potential of this business. Our work in progress in all areas of the Division remains at a high level underpinning confidence for the year ahead.

Annual report 2003

"Controlled growth... creating shareholder value" G M, Chief Executive Corporate Banking. Profits up 21% to £826m 26% growth in non-interest income Loans to customers up 11% to £50.7bnCustomer deposits up 43% to £20.2bn

Corporate Banking
Corporate Banking has once again delivered a set of strong results with profit before tax and exceptional items up by 21% to £826m (2002 £681m) notwithstanding a challenging economic backdrop for much of the year. Our clear focus on controlled growth, improved returns and credit quality, together with our proven ability to create and maintain strong relationships with our ever growing list of customers continues to create significant and sustainable shareholder value.

A 19% increase in net interest income and an even stronger 26% increase in non-interest income saw our total operating income rising by 21% to £1,435m. Our focus on added value growth aligned to sound credit quality, backed up by increased sell-down activity has resulted in a planned moderation in asset growth. However, this policy of controlled growth does not inhibit our continuing ability to attract high quality new transactions and our willingness to support existing customers as they expand and diversify. We have an enviable reputation for working closely with our customers to provide tailored, added value solutions to meet their financing needs, often with innovative, leading edge product design all supported by high quality delivery. We continue to combine true relationship banking with transactional excellence. A further increase in net interest spread was achieved, up 2bps from last year, although the overall net margin fell by 6bps, due to a reduction in net earnings on capital.

Non-interest income again increased strongly, up 26% to £560m. Growth in net fees and commissions, which rose by 15% to £409m, was well spread across all areas of

our business, while investment gains were up 83% to £42m, an extremely encouraging outcome against a difficult exit environment. Operating lease rental income also increased, up by 68% to £94m, reflecting the continued expansion of our successful asset finance activities. The cost/income ratio was broadly stable at 16.1% (2002 15.5%). Cost efficiency is and will remain a cornerstone of our Operating Philosophy and we will continue to invest in our people and infrastructure as we build for the future.

Whilst we cannot be completely immune from the pressures being faced by certain sectors of the economy, our overall provisioning experience was very satisfactory given the challenging economic environment throughout the year. Some strain was evident in certain parts of our manufacturing book and across elements of our power portfolio but encouragingly the split capital investment trust sector and the telecom sector both showed distinct improvement. The total charge for bad and doubtful debts in 2003 was £338m, equivalent to 0.70% of average advances. This was a reduction from the ratio recorded in 2002, underpinning our belief that the worst of the current provisioning cycle may now be behind us.

Non-performing assets were £838m, a reduction of £68m from the position at the end of June 2003. Expressed as a percentage of closing advances, this represents 1.65%, which is an increase over the 2002 closing position but, encouragingly, down significantly from the 1.81% at the end of June 2003. Balance sheet provisions as a percentage of advances decreased to 1.00% compared to 1.01% at the end of 2002.
As planned, our lending growth continued to slow. Total loans and advances to customers increased by 11% to £50.7bn whilst risk weighted assets increased by 10% to £58.6bn. The vast majority of this growth came in asset-backed sectors that are very well known to us and where we have a wealth of experience. We also continued to syndicate participations in larger transactions.

Since the merger, our higher profile and increased balance sheet strength have resulted in an ever-increasing number of lending opportunities. However, we do not seek growth for growth's sake and any transactions must meet our demanding risk and return requirements. Our business is based on our ability to identify, understand,

accept and manage risk effectively and we continue to decline a large number of transactions that do not meet our lending criteria. On the other hand, we are not and never will be simply a fair-weather lender. We have always been of the view that there is quality business to be transacted even in more difficult times and our business continues to benefit significantly from this "can do" approach. Our largest overall concentration continues to be property, which represents around one third of our total lending. Approximately half of this exposure is to the property investment sector where our facilities are supported by robust rental streams from a wide range of acceptable covenants. Our next largest sub-sector is residential backed lending including lending to Housing Associations. Our development exposure is largely supported by pre-sales, pre-lets or acceptable additional security. Our office-related development exposure in Greater London continues to be safe and well secured.

Customer deposits continued to grow strongly and significantly faster than advances, increasing by 43% to £20.2bn. This was as a consequence of a specific focus on this area, assisted by the introduction of attractive and innovative products. As a result our self-funding ratio now stands at 40% (2002 31%). Continued growth in such deposits remains a key focus for the Division. Operational Commentary Key Markets Operating from 22 offices in the UK and 13 overseas, the markets in which Corporate Banking operates are large and diverse and have the potential to deliver sustainable profitable growth for many years to come. We provide a comprehensive and growing range of products and services, predominantly to mid-market corporates, principally in the United Kingdom, but increasingly we are extending our core competencies to appropriate overseas markets.

Internationally, we concentrate on niche areas where we have proven skills and a competitive edge, often seeking to partner with local banks. Our franchise now includes profitable activities in Europe, North America and Australia. To supplement our continental European representation, in October 2003 we opened an office in Antwerp, which operates as a satellite to our Amsterdam office. In North America, a recent initiative has been selective partnering with regional US banks on their larger customer transactions. This is a non-threatening, mutually beneficial approach to a real problem faced by these institutions as they attempt to compete with the larger

indigenous banks. We continue to lead the market in many areas. Our Structured Finance, Integrated Finance and Joint Venture offerings, often incorporating a "one stop" mix of mezzanine and equity in addition to traditional senior debt and working capital, continue to attract significant new volumes of business whilst at the same time optimising our return on capital. In the public/private partnership arena, we continue to work closely with the public sector in the provision of social and economic infrastructure. We also continue to build selectively our Project and Asset Finance activities, moving up the value chain when suitable opportunities arise.

We established a Client Acquisition and Development team to drive a focused client acquisition programme and in conjunction with Treasury Division, we have developed Capital Markets capability to support our key product offerings in the leverage and specialist finance markets and to further improve our overall client offering.

Customer Service

We continue to challenge, consolidate and redesign our back office operations to improve customer service, increase crosssales and drive down costs. Central to this is the ongoing rollout and development of best of breed systems solutions. As well as the ongoing migration of accounts to "Core Banking", our new real time relationship banking system, 2003 saw the successful delivery of our new state of the art internet enabled on-line banking platform – IC.

Prospects

Our reputation as a strong, well-focused corporate lender is excellent and is underpinned by highly talented, experienced and committed colleagues. Our work in progress levels remain strong, providing confidence in our earnings progression. We do not expect corporate credit conditions to deteriorate and we are confident in the outlook for 2004.

A published interview

D R and J C

The interview was recorded on Monday 20 January 2003.

JC, Born in 1956, J joined S A in 1977 and spent 10 years as a fund manager followed by senior positions in IT, marketing, finance and corporate development. He led the establishment of the joint venture with J R Assurance (1991) of which he was a Director until 1994. In 1994 he joined H as Managing Director, and he became Financial Services and Insurance Director On 1 January 1999 J was appointed as Chief Executive in June 2000. In September 2001, J became Chief Executive of S plc. On 26 November 2002 he was appointed a Non-executive Director. J is a Fellow of the Faculty of Actuaries.

D R: You've been growing this business strongly, how do you make sure the wheels don't fall off?

J C: With the territory of growth comes a responsibility to ensure it converts into solid earnings. Our strategy demands tight control of costs, stable margins even though we're delivering more to our customers and sound credit quality. Even in tough times we're proving this is the strategy that delivers.

D R: But what about credit quality, you're not immune from these tough times?

J C: No we're not. One of our fastest growing areas is mortgages, they're the highest quality assets in banking. Our strategy in other banking products is to offer value and simplicity to customers of our competitors.

That really helps business quality, generally it's the better quality customers who move for a current account that pays interest and it's the better quality customers who come to you to transfer the balances on their credit cards.

D R: The same cannot surely be said of Corporate credit?

J C: No and as we'd expect in any slowdown our Corporate provisions have risen. Equally, that makes this an opportune time to lend, margins are wider, competition less intense and business propositions are more realistic.

D R: In terms of your efficient, cheap and cheerful approach to your investment products – in falling equity markets haven't your profits just been blown apart by the halving of equity markets?

J C: Yes, our investment businesses have been hit by stock markets because the stock market level does drive revenues – it shows through this year again in a significant reduction in profits from our investment businesses because of "fluctuations due to

short term investment returns" – of course recovering markets, whenever they happen, will have the opposite effect.

D R: And will you, like many life companies, be fined for mis-selling of endowments?

J C: I don't expect so but when you make any comment like that, you always touch wood.

D R: You appear relaxed about the prospects for the housing market. How are you going to survive or protect yourself in an at best, stagnant market over the next two or three years?

J C: Whatever deterioration we see in retail credit in the UK, it's likely to be comparatively benign, first because interest rates are so low and likely to stay so and second because we will see only a small increase in unemployment.

This underpins retail credit generally but also the housing market.

D R: Yes, but aren't people just overstretching themselves?

J C: Mortgage finance is much more affordable today than it has been for years – people are spending 15% of their income on mortgage finance against a long term average of 22%. There's also a real shortage of housing – particularly in the South East! We're just not heading for a significant set back in house prices.

D R: But what about lending volumes?

J C: We may have seen a boom in prices but transaction volumes over the last five years have been materially lower than they were in the late 80's in fact not much above the trend for the last thirty years. The housing market may well be slower in terms of price, but still good in terms of transaction volumes with good credit experience. Quite probably there is as much if not the same opportunity to grow the balance sheet as there has been over the last two or three years.

D R: But what about the buy to let market – the rents for many parts of the South-East are actually falling rather than rising! Do you not see that house prices are going to be under pressure as the buy to let owners start having to be net sellers?

J C: We've already seen what's happened. It's well over a year now since we saw a very significant fall in rentals in London. Why hasn't that fed through to prices? It's unusual. In the UK we are so hooked on owner occupation and the rental sector is so small that in practice we don't switch from owning to renting because of price. You would have to see rentals fall an awful long way before they really influenced

people's preferences. The fact is, rentals have fallen and people have sold vacant properties for a good profit.

D R: And are you part of the fraternity that are lending based on four times salary?

J C: Not as a general rule. Almost all lending in the UK by mortgage lenders, not just us, is on the same income multiples as were applied in the late 80's. The big difference is that on any scenario interest rates are less than half what they were then.

D R: But the housing market is still surviving because interest rates are incredibly low. God forbid that interest rates ever go up; how do lenders survive then?

J C: Interest rates would have to move up very, very significantly to get us to anything like the same interest rate stress that we had in the late 80's – and that's just not going to happen!

D R: Last year you started underwriting the creditor insurance business yourself. With a slowdown on the way wasn't that awful timing?

J C: No – in fact it wasn't that much of a change really – the nature of the arrangement we and other banks historically had with the insurers meant we were all but underwriting the business ourselves. So we don't see that the move to actually being the repayment insurer has changed our risk profile.

It has just given us more control, a greater ability to design the product to fit into our sales processes; and as a result we've achieved better sales. This is an important and profitable business, which is performing well without having a higher risk profile.

D R: Is Intelligent Finance ever going to earn an adequate return on capital for shareholders? Are you prepared to give a decade for it?

J C: As a new bank, Intelligent Finance has done all the right things: built a brand, a very powerful consumer brand, in a key part of the market. We've built assets because you never turn a new bank round to profitability without doing so, that's where the margin comes from and last year Intelligent

Finance took an 8% share of net mortgage lending. We're now building the volume to get to the required scale. The challenge isn't when we break even, because I'm sure we'll break even at the end of 2003. It's the number of products per customer. Last year that grew from 1.9 to 2.2 which shows we are well on the way to getting the number of products per customer to the level that will deliver shareholder value.

D R: But merely breaking even isn't much of a goal?

J C: That's why I say breaking even at the end exciting ambition. We will deliver it. But as I say, we're much more focused already on driving up the number of products per customer.

D R: You pay front line people very well, they appear to have share options, are you sure you're not incentivising them to sell the wrong products?

J C: Yes, they are incentivised to sell but it's not just about sales; there are all sorts of quality measures as well. Remember also, our retail strategy is based on offering customers simple products, which offer value for money.

That really does reduce the chances of mis-selling because the customer is so much more likely to really understand what he or she is buying and why.

D R: How much shareholder value destruction is represented by the purchase of S Capital at the top of the market? And are you going to do anything with the minority interest?

J C: S has a unique business model. It's a wealth management business that actually does have real distribution, not just a nice idea waiting for customers to come to it. Inevitably, this sort of business was going to struggle in the third year of a bear market but as markets recover and we see the advent of a new depolarized world, S will return to its traditional growth track. When we bought the business we said it was right for us to own a majority stake. The fact that management and the financial advisers in St. James's Place own their own bits of the business is part of its uniqueness. We think that's still right today.

D R: So is it an investment or a core part of S?

J C: Yes it is core to our strategy. We set ourselves the ambition to be if not number one, one of the two or three biggest players in investment products, a strategic imperative for an organization that is already number one in liquid savings. To be number one in investment products you have to have wide-ranging distribution, in bancassurance, IFAs and upscale wealth management where S comes into their own.

D R: On its announcement in 2000 assure was responsible for a pound hike in the then Halifax share price. Three years on what's happening, has it measured up to all the early hype?

J C: It's doing extraordinarily well, distributing through H branches, S's stores and direct using the assure brand which has established itself as the internet/telephone

motor insurance brand for safe drivers. It has a great opportunity to grow profitably in today's insurance markets.

D R: Are you out of with profits? If not, why not?

J C: Today with profits products represent roughly 25% of all our investment sales and yes, it's a market that currently provides an inadequate return for shareholders. We've said as much on a number of occasions. But the bear market has meant that capacity has been destroyed in this market in a way which will never come back. With fewer competitors, there's every chance that this market will support higher returns in the future. But if it doesn't we'll redeploy our capital elsewhere.

D R: But if Sandler's recommendations are implemented won't it make it impossible for you to earn higher returns and operate within a 1% fee cap?

J C: We'll wait and see if and how Sandler is implemented. There's not a lot in Sandler that's not already happening somewhere in the marketplace anyway. For example, the secret of our success in bancassurance is selling simple products with a single annual management fee which gives real value to the consumer. And yes, if the 1% cap is applied to with profits they won't be part of the simplified product offering Sandler so wishes to promote!

D R: Can't you build a sensible SME business without giving the product away? Isn't that what "free banking forever" is all about?

J C: We have made a big investment in building the capability and infrastructure to go into England and Wales precisely as we said we would. But we've also made great progress in attracting new customers – up 36% on last year to 273,000. The established order in SME banking has been operating in a cozy, frankly uncompetitive world. The result is, highly priced, confusing products delivered through inefficient systems. There is a great opportunity for us in bringing together Bank S's market leading capability in Scotland with H distribution systems in England and Wales, to really make a difference for SME customers – providing a real choice; one based on simplicity and value and if value means "free banking forever" so be it, we'll still make excellent returns for our shareholders.

D R: Going into a market like this, are you not going to get the poorer risks rather than the better risks coming to you?

J C: No – that's where having the Bank S's capability on the ground and being involved from top to bottom is so very important to us.

D R: Do you really think you can double your SME business within three years?

J C: Yes, that's our target, from 3% to 6% market share and we'll do it. We've already moved much faster in other banking products – products like current accounts where we were also told customers wouldn't move.

D R: Corporate banking – much has been talked about by other banks it is alleged, investing in quoted junk bonds. Given the poor business climate in the UK, is not the Bank of Scotland's high exposure to highly leveraged MBOs – not just the same thing?

J C: No. We don't invest in junk bonds, we lend on a relationship basis on individually structured deals where we are in control of the lending mandate and judgment to a very large extent. The truth is our MBO portfolio is performing pretty well in line with the rest of our book at this stage.

D R: Over the years, investors have watched Bank of Scotland consume capital like a thing possessed. With all this growth in Corporate it looks like business as usual now it's S?

J C: Our Corporate team made great strides in 2002. They showed how returns in this business could be increased even when we're suffering provisions significantly above any through the cycle average. And remember, it's returns that matter, Corporate only wins capital allocation inside S by delivering RoE!

D R: You have significant exposures to split capital investment trusts and property. Time to be scared or are you still confident?

J C: Our investment trust lending has halved as trusts have degraded into the bear market. We've said we've made some provisions in this area but not material. Our property interests are very well spread, ranging from housing association loans through to property development. We don't foresee a difficult cycle in commercial property but even so we've significantly managed down our exposure to riskier areas such as office developments in Central London.

D R: And in terms of "stakeholder pensions", do you believe that stakeholder is the panacea for either your savings or investment market or for your clients?

J C: No, there's a lot of evidence that you can CAT mark products, you can cap their charges and everything else and actually it doesn't influence what people buy. Today, most of savings products that are or could be bought are CAT marked, but very few mortgages are CAT marked. What does that tell you? It tells you the consumer will

engage with the bank or insurance company in the product they really want or need to buy regardless of whether or not it is CAT marked.

D R: Corporate governance. My own personal view is that boards with over ten members do have real problems. How do you make a board of 17 functions in a satisfactory manner?

J C: Ours is a highly regulated and complex business. Our non-executives have to devote a considerable amount of time, not just attending main board meetings but working on the various committees and getting close to the business. We have six main Audit and Risk Control Committees and all the other committees you'd expect us to have. But you are right. If 17 people got together once a month and that was all they did, it wouldn't work.

D R: Therefore their roles and responsibilities are larger than you'd expect in most non-financial services companies and therefore they get rewarded sensibly?

J C: Yes, our non-executive directors do give substantially more time, they get into the detail right across a complex business, they probably do have more responsibility and, yes, hopefully the rewards are about right.

D R: And will your senior non-executive and other non-executives be attending all your meetings with investors, as the Higgs report suggests?

J C: Probably not, but they'd be very welcome to attend all hundred plus of them that I do each year.

D R: Does S fall foul of any of the Higgs recommendations?

J C: No! Because the core principle of Higgs is that it isn't a set of rules, it is a benchmark against which PLCs that differ should argue confidently as to why their model is slightly different. The one key area where we'll be different is that we have a chairman who is chairman of two FTSE companies. On each of the occasions the board elected Dennis Stevenson to be chairman they did so full in the knowledge that he also had the role as chairman of Pearson. His appointment has served the shareholders extraordinarily well. So why on earth would we change that?

D R: Given the complexity of your business, are you and the senior management spending enough time ensuring that training and development goes on at all levels of your staff?

J C: I believe so. There are phases in any merger; the first six months is putting people into jobs and helping them to work with each other. Then a year to

18 months on you really are immersed into all the succession planning and development, which are so important for the future. One of the most exciting things about our new organization is the very high quality of people who are joining us. Internal development, succession planning and attracting top class talent into the organization are all crucial to our future.

D R: And in terms of succession planning the board takes succession planning seriously? And you're being challenged enough in your position?

J C: Oh yes! ...Definitely!

D R: Often, chief executives make sure that the next level down are open to challenge but avoid effective challenge to their own position?

J C: If we're judged to have been successful during my time as chief executive, my greatest ambition thereafter will be to pick up the newspapers and read about further success in the organization. So yes, there's plenty of challenge. I've got outstanding colleagues; colleagues who can take over from me any time.

D R: Did you raise capital to maintain your credit ratings? Are you running this business so as to maintain ratings?

J C: You can't always sustain your credit rating through all market circumstances and you shouldn't obsessively manage your business to do so. In our case though we are number one in liquid savings so financial strength is unusually important – it's part of our brand.

D R: Fine, but what constitutes financial strength at S?

J C: We would argue that we have the best balance of different businesses amongst our peers, we've got the capital we need to support growth, very high quality assets, two thirds of which are mortgages and unrivalled leverage capacity. So we'd be disappointed if they weren't reflected in one of the best credit ratings in the market, as indeed they are.

D R: And in terms of return on capital, your target in 2004 is for a 20% return on equity? It seems to me that investors simply don't believe you can get there?

J C: Yes, but with expect they're wrong. Let me ell you how we're going to achieve it. First of all we've just increased our Group Target return on Equity y over one per cent in one year from 6.8% to 17.9%. And for the future we've got a lot going for s. We've got very significant merger synergies still to come through, around £600m. In 002 we were still sustaining substantial losses in intelligent finance, which we will

eliminate. We will increase returns in a umber of divisions as we also id in 2002. But the key is Retail where we showed in 2002 how we could increase shareholder returns whilst giving better value to customers. We've achieved that through the virtuous circle of better products producing more sales, higher productivity, lower costs and so on. And for us that circle has much further to turn. So no shortage of reasons why we'll hit 20% in 2004.

D R: So presumably your costs have got to grow at 3 or 4% less than your asset base to enable you to achieve that virtuous circle?

J C: Yes, indeed – look at last year, we had a slight slippage in margins in Retail but we still had a double figure percentage increase in revenue and we had just a 2% increase in costs. And yes, we can keep that going, maybe not forever but for a few years. Simple business, you drive revenue harder than costs, you drive up returns and the real trick in this marketplace today, and you have to do it without widening margins. So we really do believe we can do more than just deliver our 20% ROE for shareholders – we can at the same time give better value to customers. That's the nature of our ambition.

D R: So over the next five years are you going to remain a UK company?

J C: We have tremendous opportunities in the UK to grow the business in pretty well every product line. We're no fans of expanding internationally for the sake of it and we will only make a major international move if it genuinely adds value for our shareholders, and if it's big enough to matter for them.

In the meantime, where we can we take our expertise abroad and add value for shareholders as we do in Australia, in Bank of Scotland Corporate Banking in the US or indeed investment products across Europe under the Clerical Medical brand.

D R: Is there a share price at which the board would sanction buying your own shares in?

J C: You are really testing our own ability to invest retained earnings at a good return. We've grown our return on equity this year; we've got a target out there to grow it over the next couple of years. So it's clear that we can deploy the capital we're generating in the business very profitably for our shareholders – regardless of short-term volatility in our share price. So the answer to your question is clear – it's no!

D R: And are there two or three key financial measures, which are in your control that you are happy to be measured by for the next three years?

J C: Yes we've got lots of public targets, in fact more than the rest of the banking sector put together. But the two financial ones that loom largest for me are; the return on equity for 2004 and the tough cost targets we have for each division – targets which define what it is we have to achieve to win on costs.

D R: And to deliver in terms of revenue growth I take it?

J C: Yes we have market share targets in lots of products but I wouldn't necessarily call them financial targets. But yes, having simple value for money products that customers buy in great volumes is critical – because that's what enables us to deliver higher returns and lower costs without widening margins against the customer.

D R: And if in 2004/2005 you failed to make that ROE target, will you consider it to be an act of God or would it be that the management have failed to perform?

J C: It'll be exactly what our shareholders tell us it is! If we hit the target the shareholders will be delighted, if we don't the shareholders must sit in judgement that is always their prerogative. I wouldn't offer any excuses but if they want to offer excuses that's fine by me.

D R: Management often benefit by backing economic growth as if it's all down to their genius whereas when it's an economic downturn or somebody else's fault it's the world economy, it's not their problem.

J C: You make running a major PLC sound like being a politician! I've been chief executive of a PLC for four years; three of them have been in the worst bear market since 1974. I believe that our business is forging a great future for itself. But you are right; it's a really tough environment in which to convince people that's the case! We can only deliver a share price that does better than its peers and over the last three years it has by 25% plus, but obviously shareholders aren't quite so impressed when the market has still dragged the share price down.

D R: Are you in denial about the size of your pension scheme deficits?

J C: No. Frankly, I think most of our deficits will be eliminated as and when markets recover. But even if I'm wrong the members of our schemes are young and, as our FRS 17 data shows, the long-term costs of putting right the deficits are eminently affordable for S.

D R: Finally, what really turns you on? What motivates you? Is it the returns to shareholders and thus your pockets? Or destroying the competition?

J C: Shareholders are our owners, ultimately we really only exist to create shareholder value. Sometimes the best way to make money for our shareholders is to make life tougher for our competitors' shareholders. But that has always been the case. We believe that in today's markets you can only achieve real shareholder value in financial services by being genuinely different. For us in Retail that means delivering value, simplicity and transparency to customers. There is no misalignment between the interests of shareholders and customers and you see that in our figures this year, very, very clearly. It is volume growth and profits growth on top of tight cost management in pretty well every business we're in. But none of this could be achieved without the enormous efforts of our other stakeholders, my 60,000 colleagues. They're the ones who really deliver for customers and shareholders.

Appendix 3 A example of case memo

Memo --- from case Bank L --- August 2004

A long-term view in mind--- relationship orientation, the attitude of bank managers --- forward thinking, partnership --- differentiator
Small companies or individual customers --- price
Large companies --- products and service + person
Aim: maintain and development

Relationship banking
Customer base --- segmentation + cost efficiency + switch cost + guarantee + Good service + Tailored products and competitive package

Add value to customer --- funding + financial advice + bring or introduce people to help within the bank + business hub or platform among customers--- keeping customer
Add value = service + tailored solutions + new insight + monitoring (board) + benchmarking + measure + compare + advice + business analysis + action planning + intermediary opportunities

Listen to customer --- customer knowledge (current situation and plan of business and needs, review of problems and needs) --- credit risk and up-selling and cross-selling opportunities --- increase of income
Bad relation or no mutual benefits --- leave
Good relation --- complain --- improvement

The role of relationship manager, intermediary people
Solution = innovation of products or informative advice
Monitoring, ongoing check
Authorisation + team support + technology
People --- differentiate the banks --- competitive advantage

People --- capability + skill --- training + working condition + compensation (salary + bonus + share option)

Information exchange

Regular contacts, review, customer preferred meeting

Trust

Public and private information (credit history, current situating, future plan) --- people to people --- trust

Origination of relationship, price + person --- acquisition of customer

Promotion of relationship, add value + keep customer + approval

Consistency

Relationship banking --- affect customer + affect performance

Balance value allocation among share holders and customers and employees --- profit + customer satisfaction + employee satisfaction

Balance risk and income

Balance high risk, medium risk and low risk

Strategy of the group

Maximize shareholder value

Clear strategic aims, plans, and capability to implement

Organic growth + acquisitions + balance short-term profit growth and investment in the future

Create sustainable long-term value for all stakeholders.

Create value for its customers --- create value for its shareholders

Service + consistency + commitment --- customer needs and expectations

Trust and confidence of its customers --- maintain lo-term relationships

Relationships with customers, suppliers, employees, the community, shareholders and competitors

Support and commitment of its staff --- skill + knowledge --- training and technology

CRM information --- understanding + product range --- meeting needs

Chosen market --- market segmentation
Chosen customer --- customer segmentation --- understanding customer needs (risk) --- fulfil needs with product range + comprehensive financial solutions --- seeking opportunities --- up-selling and cross-selling

Create customer value
Attracting, maintaining and winning a greater share of their financial service business

Understanding of customer want and its cost

Restructured its business and reinvigorate its governance and performance management process --- reward

Economic profit growth
Economic capital requirement --- market, credit, business and operational risk

Rewarding solutions

Fair employment --- recruitment, selection, retention, training, and career development

Measure as team meeting, briefings, internal communications, and opinion surveys
Share options or acquisition of shares

Appendix 4 The Theoretical Memo

This memo details some key terms which were refereed to most of the interviews with 20 managers from 15 case banks.

The nature of corporate banking: the important role of customer relationship

Corporate banking focuses on large corporate customers that have turnover more than 10 million pounds. There are fewer corporate customers than individual ones but their amount of transactions is quite big. These customers purchase several products and financial services from the banks including saving, lending, cash management, financial advice, insurance, security underwriting and some other products and services. Some of these products and services are purchased very often. Furthermore their needs may be more complex sometimes mixing some products and services together or developing a new product. The funds they need may be very large. If they demand a large loan, several banks would share the risk and provide a syndicate loan. A high percentage of banks assets are for this small number of corporate customers therefore their creditability will influence the bank risk significantly. These customers generate a large amount of interest and fee income for banks thus they affect the bank performance tremendously. Corporate banking is a very important part of banks' business and more resources are allocated to it.

Corporate banking is quite a different from retail banking as corporate customers behave differently from individual customers. In retail market banks provide very similar products and financial services and individual customers are always looking for lowest prices, most convenient places therefore price and branch location are most powerful competitive advantages. These customers can easily change their bank very often or have many accounts or credit cards in several banks. However, corporate customers are more concerned on fund availability, especially when they have financial problems, and the quality of financial services. Price is very important but they would pay a high price for a suitable product and quickly delivered financial service. No banks or financial institutions would help a company if it changed banks too often and always looking for best prices. They would like to establish a close relationship with a small number of banks that make sure they will get help when

they get into trouble. Moreover they want to choose a good bank and therefore get good service and quick delivery to support their transactions. They would like to do most of their business with the relationship banks if they are satisfied with them. They want contact with a banker who is familiar with their business and have more knowledge of their situation. This would avoid explaining the situation once again and providing more documents. The managers of companies are likely to discuss a question with a familiar banker in a relax environment.

The risks of individual customers and corporate customers are very different for banks. The risks of individual customers can be diversified among huge number of customers and the loss of a small amount of funds would not influence the safety of the bank. Nevertheless in terms of corporate customers, it is difficult to diversify the risk among a small number of customers and a loose of big amount of funds could affect the bank significantly. Some new products such as financial derivatives would increase the risk. It is important to find a way to reduce the risk and keep the sustainability of cash flows. A number of stable customers help the bank to survive and keep going. Without a stable customer base the bank does not have a solid foundation to exist and a very big change will cause insolvency. The banks are very careful about risks and have a defensive attitude towards the transactions. Keeping the customers is a pre-requisite and dominates an aggressive business strategy. Banking is a high risky industry therefore cash flow volatility and progressing sustainability will affect banks' survival and development. Without some loyal customers a bank would not survive and keep a sustainable growth. Moreover, trust is very important for banking business, which must be built on long-term transactions. It is difficult for banks to invest a big amount of funds to a customer if they do not know the customer and understand their business at the first transaction. The companies may contact with several banks and have a small amount of transaction. They may choose a bank according to their reputation and advertisement but they will leave the bank if they are not satisfied with their products or services.

Because of all the reasons outlined above relationship banking is a good way to do businesses with corporate customers. It is very important to establish long-term relationships with these corporate customers. On the one hand, companies want to

establish close relationship with banks so that they have good experience before and make sure that they will get good service in the future. Furthermore, every company will have a bad time. They want to make sure someone will help them when they have problems. On the other hand, as banking services for corporate customers are frequent businesses not occasional transactions, banks would not judge a company according to a single transaction. They are more concerned about the future transactions and other business opportunities. They want to fulfil the customers needs from the first deal and afterwards. Keeping a customer is more meaningful than make a big profit from a single transaction. The forward thinking is a principle of customer centric corporate culture. Therefore establishing long-term relationships with corporate customers is the nature of corporate banking.

The reasons behind relationship banking

Some external factors such as financial deregulation, business globalisation, and information technology development, have a significant effect on banks. Because of financial deregulation, many non-bank financial institutions begin to do banking business meanwhile banks can do other untraditional financial services such as insurance and securities. Furthermore product innovations increase banks capability to meet a variety of customer needs. Banks are free to decide their scale and scope according to their business strategy and customer needs.

The development of information technology increased the speed and lowered costs of computing and telecommunications. This helps banks to collect and process data and information of customer. Some specific software packages are designed to help their work. Information technology contributes to the development of relationship management. Technological advances combined with innovations have enabled banks to provide tailored products and financial services to meet the needs of specific customers.

Globalization is in many respects a by-product of technology and deregulation. Technological advances have lowered computing costs and telecommunications, while at the same time greatly expanding capacity, making a global reach economically more feasible. Deregulation, meanwhile, has opened up many new

markets, both in developed and in transition economies. Many banks expand their business into other countries and areas by opening a new branch or representative offices. Alternatively they expand into other markets by mergers and acquisitions. Furthermore, Many banks expand into some untraditional businesses such as insurance and security underwriting. Some commercial banks merged and acquired investment banks and insurance companies to form universal banks during the last two decades.

The competition in banking industry is increased from non-banking financial institutions and foreign banks because of financial deregulation and globalization. In order to survive in this competitive environment banks need to secure their customers. In turn establishing close relationships with customers reduces banks competitive pressures.

In general external environmental changes have a significant effect on banks. These factors individually or mixed pushed the development of relationship banking. The advances in information technology help banks to collect and process more customer information and provide more communication channels and improve the speed and efficiency of information exchanges. The software packages make the relationship management more effective and expand into some other customer groups that it is impossible to do relationship management before. The even increased competition in financial market makes banks more eager to secure their customer. Financial deregulation and globalization make it possible for banks to fulfill customer needs in terms of products and financial services and the locations of branches. Furthermore financial deregulation makes it possible for banks to explore cross-selling opportunities if they established close relationships with customers.

However, some reasons may be more important for relationship banking from the relationship managers' point of view. These reasons were stressed as important by many interviewees. One of them is gaining knowledge of customers' business then banks are able to quickly respond to their financial requests (information and knowledge function). It will be best to identify their needs and requirement and match that with banks' products and services, which are available in their own range. The

second is that customers want to know how banks will react to their requests of providing finance. In other words customers want to make sure that they will get help when they get into trouble (Insurance function). Banks work together with customers when they get difficulties to resolve the problems. Banks will put some more money and change the formula and work it through. Otherwise banks need to precede financial solvency and get lose from this bad debt (Recovery function). The third reason is that a good long-term relationship with a corporate client usually means banks have a good advocacy in the market place. They will tell their colleagues and friends they get a good service, a good responsive service from their bank. It is a much better way to get new clients (Advocacy function). The fourth is that traditionally having large corporate clients will bring ancillary business, because the large corporations are visible in the market place. The cheques come from large corporate and the banks they use are visible to the lower level of economies standing beneath. So the smaller businesses or the individuals will choose the bank as well. There must be good services, good products, or good delivery for the multinational to use so the smaller businesses or individuals will also consider the bank as their linkage (Example function). The fifth reason is that banks gain more from cross-selling more products to the same customer. Fee incomes are more and more important part in their total incomes (Cross-selling functions). Meanwhile, Customers can complete their financial services in a one-stop banking institution. These are the main reasons for establishing long-term relationship between customers and their banks. The sixth is that when banks open an account and service, a relationship with the customer the cost involved decrease with time. When you open an account, the cost might be equivalent what made earn from the account for next three years. Beyond that, the bank will start to make return from that product. That would be where the long-term relationship comes in. Corporate customer businesses need to pass a volume of service and products, the volume of transmission, the volume of processing and the bank needs to aggregate some transactions to deal with volume basis then the incomes will be more than the fixed overhead and make net profit (Cost saving function).

The external factors make the economic environment more and more competitive. Establishing customer relationships do reduce competition among financial

institutions and even make cooperation possible within the financial service industry. However it seems that internal managerial factors make relationship banking necessary. Relationship banking is a good way to do business in corporate banking.

Relationship banking: a business strategy

Establishing close relationships with customers takes quite a long time therefore it is necessary to have a relationship-centric business strategy. A business strategy needs to cover aims, the ways of achieving them, resources and tactics, the ways in which resources that have been deployed are actually used or employed. The objective of relationship banking is acquiring and retaining the most valuable customers. Most interviewees agree that the Pareto Principle holds that 80% of revenues comes from 20% of customers. Therefore it does make sense to pay more attention and allocate more resource to corporate banking as corporate customers generate great contribution to banks' profit. The relationship oriented culture means that banks treat their corporate customers as a fundamental asset and the origination of incomes and their business partners. Customer oriented culture aims to deliver superior customer value. In other words the objective of relationship is improving customer value. Only if the bank add value to customers it is possible to satisfy the customers and keep the customers. If the customers lose value because of unsatisfied products and services they would leave the bank and switch to some other banks. Meanwhile banks get value from the products and financial services. This is the concept of customer value from the perspective of the value of the customer to the banks, the profitability they generate from each customer.

How do banks improve customer value? In other words the way banks deliver good products and financial services to satisfy customers needs then keep the customers as long as possible. The satisfied customers do not necessarily stay with the bank but retained customers are satisfied with their banks services being at least as good as the other banks. Because of the switch cost customers would not change their banks even if they are not very satisfied with a single transaction but they would leave if they were unsatisfied again and again. So regular contact with customers and listen to their opinion and respond to their complains. In corporate banking market if a corporate customer changed the banks often the other banks will consider about their

creditability and would not accept it. A corporate customer needs to spend quit a long time to establish a new close relationship and cost a lot. If a corporate customer does not have any close relationship with any banks it will have such a risk that nobody would help when they have a problem or even worse get into trouble.

As the relationship is a relationship between people who represent the organisations therefore trust between these people is very important. The trust among people is affected by some factors in corporate banking. The first one is the appearance of the person and his or her individual characteristics. The impression of a person at first glance is quit important. Interpersonal trust relies on early impressions of perceived trustworthiness and actual follow-through. Therefore it is important to choose trustworthy people as relationship managers and keep consistency through out the time. Employee Retention is an important factor, which will be discussed later. Another factor is the attitude of the relationship managers and the way they treat the customers. A friendship between people also means a friend partnership between their businesses. They may introduce more businesses or partners to their customers that add great value to customers. The third is the knowledge of the relationship managers. If the relationship managers have got more knowledge about the customer he or she can understand the customers business. If the relationship managers have got more knowledge about their own products and financial services they can provide better solutions to the customers. A suitable product or service and a quick delivery will add more value for the customer.

The nature of this relationship is personal. It is a relationship between people although they represent banks and companies. They can trust each other and exchange information by establishing long-term relationship. The quantity and quality of exchanged information depends on the extent of the relationship. Banks need to treat the customer as a valuable asset for as long as possible. Being consistent is very important in this long-term relationship. Banks must keep their words and deliver what they promised to the customers. Companies need to disclosure their information as much as possible and complete their contracts. Any defaults or unachieved transactions will damage even stop the relationship. The lost of this connection will cost a lot for both sides. It takes a length of time and a mount of

money to build a trust based relationship. Relationship managers need to take good care of the relationships. The relationships need to be cultivated to keep them healthy and they need to be developed continuously.

A sustainable competitive advantage: people

The strategy must be supported by appropriate resource and tactics. The human resource is the first factor. The competitors can replicate innovated products and services, advertising programmes, the organisational structure, the reward system but can not replicate the people. People are the most important assets of companies and the intellectual capital of the firm. Employees are also been treated as internal customers. Their attitude, knowledge and capability of resolving problems are very difficult to replicate. Attracting, recruiting and retaining relationship managers are very important. Employee relationship management is an important part of relationship banking. Employee satisfaction indexes and retention rates are important components in relationship banking performance measurement, which will be discussed in a later part of this paper. The interviewees argued that it is important to build a relationship oriented culture including people centric and customer centric attitude through out the organisation at all time. Relationship managers' knowledge is another component of human resource. Relationship managers are generalists that they need to know the organisation, the products and services, the historical and the current situation of the customer although they do not know everything and cannot do everything for customers. They must try to get information as much as possible and must know the customers and understand their business.

Customer knowledge management

The interviewees argued that customer knowledge and information are critical for doing businesses. Collecting customer information and processing the information using appropriate technology help relationship managers to make a quick decision. Customer information needs to be put together from all functional departments and be available throughout whole organisation. A single view of customer information can be supported by an information technology platform. Moreover this centralised database also helps internal information exchange. It may be useful for reducing adverse selection and moral hazard problems. Theoretically, relationship concept has

existed for decades but it emerged to the central stage in late 1990s along with the rapid development of the IT industry in developed countries. CRM software may be helpful for collecting customer information and making decisions.

The capability of processing customer information and designing financial solutions is a critical requirement for relationship managers. Therefore a continual learning system will ensure that the relationship managers receive training to keeping pace with modern knowledge and techniques. The relationship managers need to regularly join some internal and external training programmes.

It is necessary to allocate the scarce resource into the most efficient businesses. The cost efficiency needs to be considered when deciding an investment. Keeping a customer is much easier and more efficient than acquiring a customer and building a true relationship. Acquiring a customer would cost more than six times than keeping a customer. A 5% reduction in customer defection rates will have a significant beneficial effect on the net present value (NPV) of a customer. Therefore banks need to allocate more resources to retaining existing customer. This is another reason for relationship banking that a defensive business strategy is more often chosen for corporate banking.

Organizational structure of relationship banking

The human resources and information technology investments are allocated to relationship banking. However the way of organising these resources more efficiently is critical for relationship banking. Relationship managers are organised around customer groups instead of around different products and financial services. In the retail market individual customers will go to different windows or desks for different services. Nevertheless in the wholesale market corporate customers will go to see their relationship managers when they have any requirements. Relationship managers are main contact points for customers. The customers tell the relationship managers what their problems are and what their needs are. The relationship managers design a solution or a suitable product or service for the customer. The relationship manager will organise the business and find suitable experts to deliver this transaction. As corporate banking services are more complex and needs cooperation between

different functional departments. Teamwork is necessary and suitable in corporate banking. Furthermore teamwork can reduce moral hazard problems and hence the agency costs of the organisation. As the relationship is person-to-person relationship teamwork can reduce the possibility of conspiracy between people representing the bank and the company. As the relationship manager is the main contact point between the bank and the customer any changes or leaves of relationship manager may damage the relationship or even terminate the connection another relationship manager in the team will replace the role and quickly take over the business. The organisational structure needs to facilitate the cooperation within the team and between the team and other functional department.

In this organisation relationship managers need to take the responsibility when their customers have any requirements because they are main contact points with customers. They need enough authorisations from their higher-level managers and enough support from their colleagues. Without their cooperation relationship managers will not complete any transactions. Trustworthy experienced managers are selected as relationship managers and they are assigned as the team leaders. Internal trust is also important when help from other functional departments is needed. The information channels need to go through from relationship managers and their high level managers. The timely exchange of information makes the higher-level managers supervision efficient. This helps building higher-level managers' trust and facilitating handing over power to the lower level managers. The information needs to be available to other functional departments. This makes the business more transparent and helps the trust and cooperation between groups.

In general, the relationship manager team could be suitable for complicated financial services. Furthermore this teamwork design will improve internal trust and cooperation in the organisation and increase efficiency. Information can be exchanged vertically between different levels and horizontal among different functional departments.

Performance measurement and incentive system

Most interviewees stated that in order to make relationship banking more effective and efficient the performance needs to be measured appropriately and rewarded accordingly. Firstly, as relationship banking is a long-term strategy the short-term value and long-term value need to be balanced in the measurement matrix. Periodical profit such as return on equity, and customer value such as customer satisfaction are weighted. The customer portfolio will be checked at anytime by the relationship manager and any changes need to be reported. Customer satisfaction and retention rates are important indexes to measure long-term customer value. Customer lifetime value (CLV) is an important concept for measure customer value as an asset but it is not easy to calculate precisely in practice. Secondly, because relationship banking is designed in teamwork individual contribution and team performance need to be weighted. Individual performance and team performance need to be analysed separately but each manager's contribution cannot be treated equally. Thirdly, relationship banking is dealing with risk therefore the performance measurement need to balance risk and return. Risk adjusted return on equity (RAROE) is a measure often used in many banks. Different customer group would have different risk and each customer has it own credit rating. The return from different sectors and different customer need to be adjusted in terms of their different risks. Fourthly, the tasks maybe adjusted according to different economic conditions thus keeping customers and acquiring need to be weighted differently and both market share and customer share need to be considered. When the economy as a whole is depressing a more defensive strategy would be adopted and customer retention need to be weighted more. On the contrary a more aggressive strategy would be adopted and customer acquisition would be weighted more when the economy is expanding. Banks always try to avoid big changes and surprises therefore sustainability and certainty would be preferred to uncertainty. A relationship banking performance measurement includes both qualitative measurement and quantitative figures. For example, risk adjusted return on equity (RAROE) and customer retention rate are utilised to measure time period performance. Customer satisfaction is measured to reflect their customer attitude and predict their future behaviour.

A relationship related reward package compensates the relationship managers according to the performance measurement. The performance measurement balances short-term and long-term value, risk and return, individual performance and team performance, market share and customer share, customer acquisition and retention. Firstly, the reward system needs to consider the legal issue and regional payment level and sector level as a benchmark. It is important to keep the payment competitive in the market but need to also consider the cost budget. Secondly, the relationship managers need to be paid for their routine activities of keeping the organisation run. This is the basic part of the payment related to the performance of the institution as a whole. Thirdly, the payment need to consider the team performance related to the cooperation within the team. Fourthly, the performance related to their customer portfolio and new customers acquired need to be paid. Finally, the component of the compensation includes basic salary, bonus and share options and other benefits such as an honour, a holiday. A nice working environment will make the employees working effectively and decentralised leadership will increase their cooperation. The career development will increase employees' satisfaction hence employees' retention rate. The incentive system will support their work and make them work more actively and enthusiastically.

A dynamic theoretical model of relationship banking

In conclusion, relationship banking is a strategic choice for corporate banking to improve customer value in a customer-centric structured organisation with a relationship-oriented culture, trust-based regular communication with customers, customer-related performance measurement and employee an incentive system.

The objective of relationship banking is improving customer value. Customer value has been used in a variety of contexts. This paper chooses the concept of customer value from the perspective of the value of the customer to the organisation - the profitability they generate from each customer (Woodruff, 1995). According to the resource-based view of the firm (Wernerfelt, 1984; Barney, 1991), customer relationship is a sustainable competitive resource. Creating customer value is increasingly seen as the next source of competitive advantage (Woodruff, 1997).

The nature of the customer relationship is trust-based regular communication that is the exchange of information. Communication develops a shared understanding of the relationship by keeping an open dialogue with customers, hearing complaints and keeping customers informed of changes. Trust is important for determining the quality and quantity of information. It is desirable to make trust part of the corporate culture into the procedures, policies and practice of the organization and its employees (Harrison, 2003).

The superior performance accrued to firms that have a customer value-based organisational culture, complemented by being skilled at learning about customer and their changing needs and at managing the innovation process, and that organise themselves around customer value delivery processes (Slater, 1997). A relationship oriented culture aims to deliver superior customer value. Customer value process-focused organizational structures provide a foundation for developing and implementing this culture. These banks use a cross-functional process approach, rather than the traditional approach to managing customers, which divides up responsibility for various aspects of the relationship with the customer between different departments. This process approach is that companies are organised around customer groups.

In a traditional product centric company, vital customer information exists in different product lines and functional departments throughout the enterprise. Nevertheless, companies must be able to provide employees with an accurate and comprehensive picture of each customer's background history, current business and anticipated needs. An integrated view of customers empowers the organisation to efficiently respond during customer interactions to quickly answer questions, resolve problems and further market targeted products and services. Similarly, customer expect to resolve all their needs with a single point of contact, regardless of whether that contact is via phone, fax, storefront, mail, or the web. This requires improving and increasing communication both internally across departments and then externally to the customer where every point of contact must be consistently satisfying.

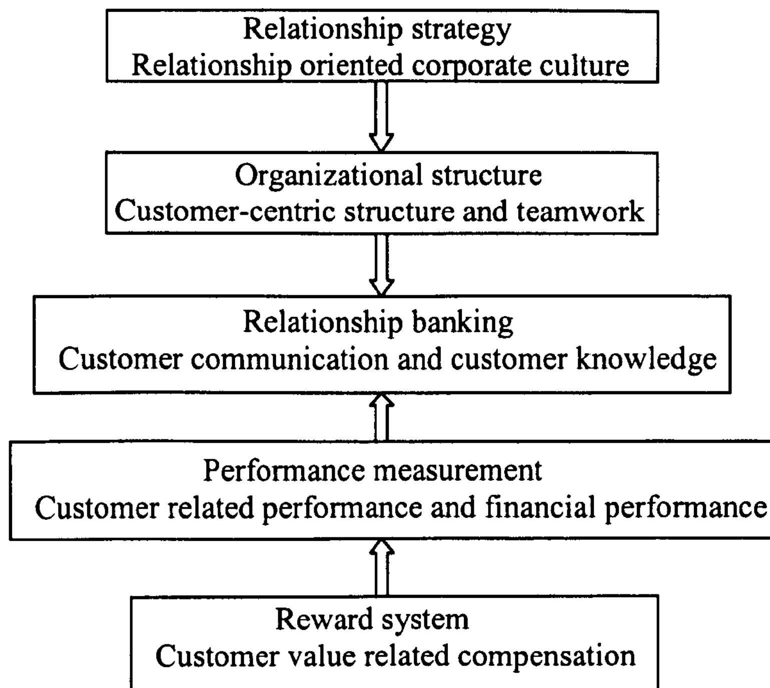
In a customer-centric organisation, employees can be provided with a single customer view -- the ability to understand and leverage every interaction a customer has with the organisation. Companies can identify their most profitable customers. Meridien Research shows the unequal distribution of customer profitability that 20% customers produce 150% profit and others incur lost. By identifying customers in terms of their value and selecting one or more groups as a target segment, companies can begin to think about how to deploy revenues to nurture, cultivate and develop the most important customer relationships.

Knowing customer's needs and expectations and satisfying them by developing products and services are essential for keeping customers. Information technology has an important role to play in enabling companies to record each customer's information (Fletcher, 1999). Organisations develop the appropriate information technology platform to suit their requirements, now and in the future. The implement of information technology will assist to identify opportunities for increased profitability through enhanced customer acquisition, improved customer retention and targeted cross selling.

A strategic performance measurement and incentive system is also important for relationship banking. The Balance Scorecard method mentioned by interviewees is increasingly implemented in strategic performance measurement system combining qualitative and quantitative measurement. As relationship portfolio-based incentives are usually team or group in nature, it is important to balance individual performance with teamwork.

Because employees need more advanced and complex skills, it is essential that each employee receive the skill and competency training. Employees also need to have job-appropriate learning opportunities in which to transform received knowledge into applied expertise: also known as "Experience". Therefore, human resource management is also called internal customer relationship management.

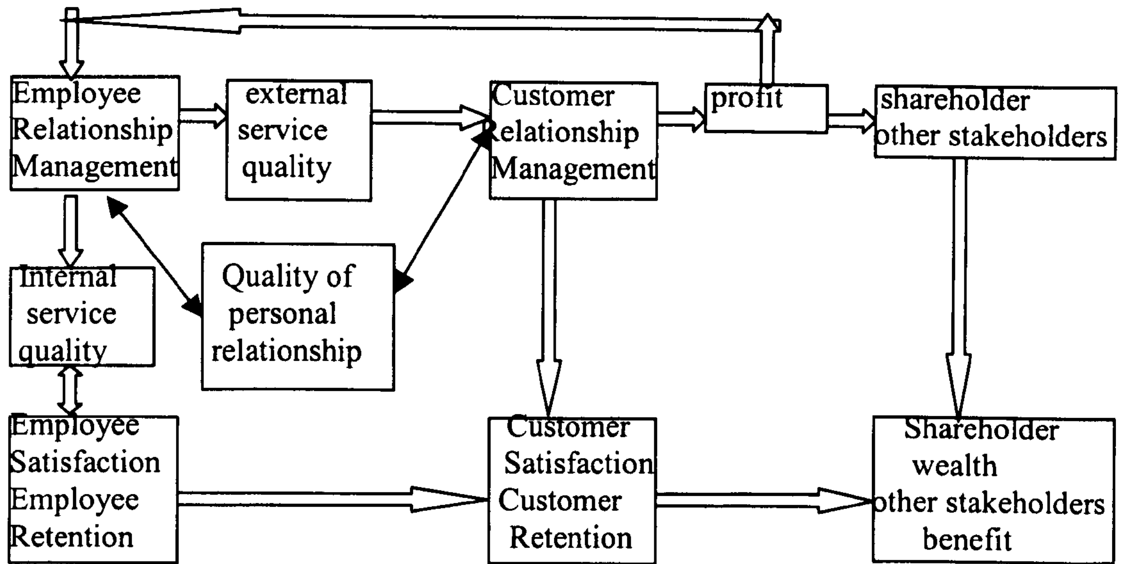
The theoretical model of relationship banking (Developed in June 2005)



Customer relationship is a valuable asset of banking firm according to resource-based theory. A customer information and knowledge leaning organisation can reduce information asymmetry by establishing trust-based long-term relationships with customers. Customer value is a competitive advantage over competitors. Well-trained experienced employees are sustainable competitive advantage and the origination of value creation. The process of value creation through value chain is from employees to customer and shareholder. The employee adds value to customer and customer returns profit to shareholder and employee. The value is allocated among shareholder, customer, employee and some other factors.

Bank is a value creation and allocation organisation. It exists because it creates and allocates value efficiently and effectively. The size and scope of performance depend on capability of value creation and allocation, which in turn depends on the intellectuality of employees, organisation structure, and management mechanism. The organisations which have more competitive advantages and processing system will out perform the others then survive and keep on developing.

Value Creation and allocation process of relationship banking (Developed in June 2005)



The relationship banking system needs to be improved according to ever changing environment. A balanced score card of body checker to measure the efficiency and effectiveness of relationship banking system and accordingly one part or whole body is adjusted accordingly.

Appendix 5 The Storyline

The phenomenon of interest in this investigation was bank-customer relationship in corporate banking. The context was the active market for corporate banking services made up of banks, corporate customers, employees and shareholders. A simple figure illustrating the "paradigm model" is prepared on page 3.

The causal macro-conditions influencing relationship banking included business globalisation, financial deregulation and the development of information technology. The micro-conditions included credit risk, customer information, cost saving and cross-selling. The intervening conditions included customer preference, complex needs, financial problems.

On the one hand, the competition in the banking industry has increased from non-banking financial institutions and foreign banks because of financial deregulation and globalization. Customers have more financial options and ever changing preferences due to the development of capital market and the advance in technology. The corporate customers demanded more complex financial products and services. Therefore banks were more eager to secure their customers in this intensively competitive market. On the other hand, financial deregulation and globalization made it possible for banks to fulfill customer needs in terms of products and financial services and the locations of branches. The advances in information technology enabled banks to collect and process more customer information and provide more communication channels and improve the speed and efficiency of information exchanges. Furthermore financial deregulation made it possible for banks to explore cross-selling opportunities hence obtained more revenue. Thus more and more banks realized that the customer relationship is key for surviving and future development.

Moreover some micro causal conditions might be important for relationship banking from the relationship managers' point of view. Credit risk is a core issue in corporate banking. Gaining more customer information and knowledge help banks to evaluate credit risk and make decisions. Relationship managers developed tailored solution and priced the financial products and services. Regular communication and

consistency over time help banks to build trust in this mutually beneficial relationship. By gaining more information and knowledge of customers' business banks were able to quickly respond to their financial requests and explore cross-selling opportunities. In addition, customer retention is more cost effective than customer acquisition.

Customers wanted to get help when they have financial problems and therefore they would like to keep a long-term relationship with a reliable bank. Banks worked together with customers to resolve the problems rather than precede financial insolvency and get a loss. Furthermore a good long-term relationship with a corporate client means that banks had a good advocacy in the market place.

The initial action involved the choice of a relationship banking strategy. It consisted of a relationship oriented corporate culture, a customer-centric organisation structure, relationship managers and teamwork, customer related performance measurement, and a customer value related reward system.

The relationship oriented culture means that banks treated their corporate customers as a fundamental asset and the origination of incomes and their business partners. Customer-centric organizational structures provided a foundation for developing and implementing this culture. The employees were allocated around customer segmentation and a relationship manager was assigned as main contact point backed up with a supporting team. Trustworthy people were selected as relationship managers and they are aimed to keep up a consistent level of service through time. The trust between people who represented banks and companies was built through regular communication over time. Relationship managers received competency training to get advanced and complex skills to develop tailored financial solutions and provide advice for customers.

In order to make relationship banking more effective and efficient the performance needed to be measured appropriately and rewarded accordingly. The performance measurement balanced short-term and long-term value, risk and return, individual performance and team performance, market share and customer share, customer

acquisition and retention. A customer value related reward package compensated the relationship managers according to the performance measurement.

As a result the banks perceived that sustainable competitive advantage arose from maintaining skilled, experienced employees. Employee satisfaction and retention influenced the internal trust and cooperation and the internal service quality. They also influenced the attitude and external quality of providing financial products and services to customers and consequently influenced customer satisfaction and retention. In addition the quality of personal trust also influenced the customer satisfaction and retention. By keeping valuable customers banks obtained more sustainable profit from reducing risk and identifying cross-selling opportunities. Eventually this also increased shareholder wealth.

The intended consequences included sustainable profit, increase of revenue, cost effectiveness, employee satisfaction, employee retention, customer satisfaction, customer retention, and shareholder wealth.

The paradigm model of relationship banking (developed in July 2005)

CONTEXT

Active market for

Corporate banking services

CAUSAL CONDITIONS

Macro

Business globalisation

Financial deregulation

Technology advance

Micro

Credit risk

Customer information

Cost saving

Cross-selling

CENTRAL PHENOMENA

Relationship banking

INTERVENING CONDITIONS

Customer preference

Customer complex needs

Customer financial problem

ACTION/INTERACTION

Relationship oriented corporate culture

Customer-centric organizational structure

Relationship manager training and teamwork

Customer related performance measurement

Customer value related compensation

CONSEQUENCES

Sustainability

Income increase

Cost effectiveness

Employee satisfaction

Employee retention

Customer satisfaction

Customer retention

Shareholder wealth