

Banking Strategy

Module Introduction and Overview

Contents

1	Introduction to the Module	2
2	The Module Authors	2
3	Study Resources	3
4	Learning Outcomes	4
5	Module Overview	4

1 Introduction to the Module

Welcome to the *Banking Strategy* module. The world of banking has changed considerably in recent years, particularly since the crisis of 2007–09. This module aims to give you a good understanding of the characteristics of the financial system and the role of intermediation, as well as the implications of recent structural changes for bank management and external corporate control. You will learn about banks' sources of funding and how the environment after the 2007–09 crisis transformed their funding choices.

The module also aims to provide an analysis of the factors that can contribute to success or failure in the execution of banks' mergers and acquisitions (M&A) transactions, and the cultural challenges that may be crucial to the success of an M&A deal involving banks. We hope that your study of the module will enable you to evaluate the business strategy and implementation failings that have given rise to bank failure and to assess the benefits and costs from regulation of the financial services industry, and the net regulatory burden faced by the banking industry.

In its analysis of the banking industry, and the changing regulatory frameworks associated with it, this module will use a range of examples and case studies to illustrate the theoretical principles introduced in the unit texts. There are also many review questions and exercises incorporated into the module to facilitate your learning.

After completing this module, you should be able to outline the mechanisms of regulation of financial institutions and financial markets, and analyse changes in regulation following the financial crisis of 2007–09.

2 The Module Authors

Norman Williams graduated with an MA in Economics from the University of Manchester and worked in a variety of research and advisory roles at the Bank of England, specifically in the areas of monetary policy, financial markets and banking regulation. He moved to H.M. Treasury where he worked on exchange rate policy and implementation, the strategic management of the official reserves and government borrowing. Thereafter, Norman worked for a large global investment bank focusing on European economic and investment research and advice. Norman is now a full-time academic specialising on banking and finance.

Dr Jonathan Simms is a tutor for CeFiMS, and has taught at the University of Manchester, University of Durham and University of London. He has contributed to development of various CeFiMS modules including *Econometric Principles and Data Analysis*, *Econometric Analysis and Applications*, *Financial Econometrics*, *Introduction to Valuation*, *Risk Management: Principles and Applications*, *Public Financial Management: Reporting and Audit*, and *Introduction to Law and to Finance*.

Peiyi Yu is a Senior Lecturer in Finance at the University of East London. Her current research interests include hybrid bank capital securities, panel data econometrics, asset management, corporate governance and executive compensation. She obtained her PhD in Finance from the University of Birmingham and has taught and conducted research at the Universities of Wolverhampton, Tübingen and Chi-Nan (Taiwan).

Bac Van Luu is in the Allocation Strategies Department at Norges Bank Investment Management (NBIM), the manager of Norway's Sovereign Wealth. He has also worked in Bond Markets/Economics Research at Landesbank Baden-Württemberg and a Research Analyst in the Capital Markets Group at Russell Investments in London. Van received his PhD in Economics from the University of Birmingham.

3 Study Resources

This study guide is your main learning resource for the module as it directs your study through eight study units. Each unit has recommended reading either from the module key text or from supplementary readings. The module also comprises a range of case studies.



Key text

The key text for this module is:

Roy Smith, Ingo Walter and Gayle DeLong (2012) *Global Banking*. 3rd Edition. Oxford UK: Oxford University Press.

This is a comprehensive and useful text, which analyses global banking and finance, and assesses ongoing strategic changes to the industry.

Module readings

Where there are gaps in the core text's coverage, these will be supplemented by articles and extracts from other sources. You are provided with access to a range of academic journal articles, extracts from supplementary textbooks and other reports or material.

Case studies

The theoretical concepts examined in the module material will be supplemented by case studies, looking at actual industries and how their own accounting standards relate to international standards.

4 Learning Outcomes

When you have completed your study of this module, you will be able to:

- analyse the particular risks banks are exposed to as a direct result of the intermediation process
- assess the degree to which a bank's strategy may lead to an optimal level of risk, for the bank and for the financial system as a whole
- describe the financial intermediation linkages in a financial system
- analyse patterns of structural change and strategic positioning over cycles of globalisation, deregulation and consolidation
- describe the sources of funding for banks and discuss how they affect banks' profitability and risk
- explain the sources of risk facing banks
- discuss the changing nature of risks facing banks in emerging economies
- explain the causes of the global financial crisis of 2007–09, identifying the features that were unique to this crisis, and those that are common to other crises
- analyse the business models which made some banks especially vulnerable in that crisis
- consider the strategic implications for banks of the regulatory environment.

5 Module Overview

The module is structured around eight units, which should be studied on a weekly basis. It is expected that studying each unit, including the recommended readings and activities, will take between 15 and 20 hours. However, these timings may vary according to your familiarity with the subject matter and your own study experience. You will receive feedback through comments on your assignments, and there is a specimen examination paper printed at the end of this introduction to help you prepare for the final examination.

Unit 1 Financial Intermediation – Dynamics and Governance Mechanisms

- 1.1 Introduction
- 1.2 Review of Financial Institutions and Systems
- 1.3 Governance Mechanisms
- 1.4 Core Incentive Problems and the Breakdown of Corporate Governance
- 1.5 Case Study
- 1.6 Conclusion

Unit 2 Strategic Drivers of Structural Change in Global Banking

- 2.1 Introduction
- 2.2 Financial Intermediation Dynamics
- 2.3 Structural Change in Global Banking
- 2.4 The Basics of Banking Strategies – A Simple Strategic Schematic

- 2.5 Drivers of Strategic Strengths and Weakness
- 2.6 Case Study
- 2.7 Conclusion

Unit 3 Strategy and Strategic Positioning

- 3.1 Introduction
- 3.2 A Tool for Strategic Thinking – The C-A-P Model
- 3.3 Globalisation, Regulation and Consolidation
- 3.4 Specialist versus Universal Banks
- 3.5 Sources of Competitive Advantage
- 3.6 Strategic Choices
- 3.7 Case Study
- 3.8 Conclusion

Unit 4 Acquisition and Use of Funds

- 4.1 Introduction
- 4.2 Sources of Bank Funding
- 4.3 Disintermediation and Competition from Non-bank Participants
- 4.4 Funding Models Before, During and After the 2007–09 Crisis
- 4.5 Case Study
- 4.6 Conclusion

Unit 5 Banks' International M&A Deals

- 5.1 Introduction
- 5.2 Reasons for M&A Transactions
- 5.3 Consequences of M&A Transactions
- 5.4 Financing M&A Transactions
- 5.5 Case Studies
- 5.6 Feedback on the Case Studies
- 5.7 Conclusion

Unit 6 Managing Bank Risk

- 6.1 Introduction
- 6.2 Risks Facing Banks
- 6.3 Management of Bank Risks
- 6.4 The Changing Nature of the Risks Facing Banks
- 6.5 Case Studies
- 6.6 Feedback on the Case Studies
- 6.7 Conclusion

Unit 7 Business Models and Systemic Risk

- 7.1 Introduction
- 7.2 Financial Crisis
- 7.3 Business Models
- 7.4 Risk Management Lessons from the 2007–09 Financial Crisis
- 7.5 The Future Shape of Banks
- 7.6 Case Studies
- 7.7 Feedback on the Case Studies
- 7.8 Conclusion

Unit 8 Dealing with Regulatory and Compliance Issues

- 8.1 Introduction
- 8.2 Contradictions and Trade-Offs in Regulation
- 8.3 Regulatory Options
- 8.4 Financial and Market Supervision
- 8.5 Regulation after 2007–09
- 8.6 Case Study
- 8.7 Conclusion

This module is particularly concerned with the role of banks in the 2007–09 financial crisis, and subsequent attempts to provide a regulatory framework that might serve to lessen the risk of bank failure. The units provide both an analysis of the issues at stake, and real-life case studies to show how they have worked in practice.

Unit 1 reviews the essential characteristics of financial systems and, specifically, the financial intermediation function provided by banks and other deposit-taking institutions. Various theories are explored concerning the composition and role of boards of directors, and the relation between boards and management. The unit then analyses evolution in the global financial environment, how this affects the strategic behaviour of bank management, and the implications for corporate governance of banks.

Unit 2 considers the environment in which banks manage their strategies. It examines the strategic drivers of structural change in global banking, including economic factors, technological changes and regulatory changes.

In **Unit 3** you will study the client-arena-product model as a tool for strategic thinking. The C-A-P model is used to analyse various sources of competitive advantage, and to examine the challenges and opportunities facing financial firms. The unit also examines structural change in financial markets, over cycles of globalisation, deregulation and consolidation, in the context of the C-A-P framework.

Unit 4 examines the various sources of funding used by banks, including retail deposits, bonds and interbank loans, and equity. It considers the acquisition and use of funds from the 'originate and distribute' model to one that stresses the need to 'acquire and arbitrage'. You will see how the optimal mix of funding changes as banks respond to financial innovation and competition for funds from non-banks, and to changes in regulation.

Unit 5 considers the strategic rationale for banks' expansion through mergers and acquisitions (M&A) rather than organically, and assesses the degree to which such deals have worked. There is also a focus on the financing of such transactions.

Unit 6 focuses on the changing nature of the risks facing banks and the techniques that banks use to manage risk. The chief risks studied include credit risk, liquidity or funding risk, interest rate risk, market risk, operational risk, country risk and systemic risk.

In **Unit 7** you will study banks' different business models, some of which made them especially vulnerable in the global financial crisis of 2007–09, while other banks were able to withstand the crisis largely unscathed. There is also a discussion of the lessons for risk management to emerge from the crisis.

Unit 8 examines the arguments for and against regulating the financial services industry, and outlines the regulatory mechanisms available. It considers the trade-offs involved in regulation, and assesses the benefits and costs of regulation to banks. The influence of the regulatory environment on strategic decision making is examined. These themes are explored in the context of reforming regulation following the financial crisis of 2007–09, at the national and international level.