SHAREHOLDER VALUE CREATION IN THE BANKING INDUSTRY DURING TURBULENT TIMES

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1.0 Introduction

The banking industry is feeling the financial turbulence more than ever, brought about by the effects of globalization, demographic trends, regulatory shifts and modern technologies etc. In order to manage financial institutions, it is crucial to have the insight to understand these current trends and their impact on the financial services market to create value in the industry. This article is based on a study conducted by the Boston Consulting Group (BCG) USA in March 2008, on managing shareholder value in turbulent times. BCG is a global managing consulting firm founded in 1963, and the world's leading advisor on business strategy. It operates through 66 offices in 38 countries and annually conducts study of shareholder value creation in the banking industry.

The above study focused on the global banks' performance in year 2007. The sample comprised of 593 stock-market-listed global and specialized companies in the banking industry, which include all major banking players and represent over 75% of the industry's total market capitalization as of January 2008. Five segments have been identified in the sample : (1) Universal and Diversified Banks with a broad business portfolio; (2) Investment Banks (providers of capital market services and corporate finance); (3) Asset Managers (providers of retail broker services and money management, including investment, budgeting, banking, and taxes); (4) Consumer Finance Businesses (credit-card companies and providers of personal finance services); and (5) Mortgage-Finance Companies (providers of mortgages and mortgage insurance). Based on the above study, the author discusses the state of the global banking industry in 2007 and quantifies the drivers of value creation for short-term (one year) and long-term (five year) performance in the global banking industry.

Further, the article highlights how banks can implement an integrated approach to strategy development - which places Total Shareholder Return (TSR) at the centre of the process. TSR measurers the change in a company's stock price and/or gains from reinvesting dividends paid in a particular period. It is the percentage change of the return index on a given stock. In the above

BCG's study TSR has been adjusted for two elements : (1) the impact of local stock market performance and (2) the impact of risk, to measure the true capital market performance of a company. It is crucial to have a clear and robust TSR in turbulent times. BCG suggests, that the banks should revisit their strategies for creating shareholder value, to gain more control over their plans. This could be done by pursuing an integrated approach that fuses financial, investor, and business strategy and focusing on an explicit TSR goal. Further, the BCG believes, a TSR approach recognizes that a business strategy choices need to be informed by financial and investor strategy at the very beginning and not after a business strategy has been decided. Based on their research, the BCG recommends that four steps are essential to develop an integrated value creation strategy : (i) set an initial TSR goal, (2) build a fact base, (3) create strategy scenarios, and (4) apply an agreed-upon TSR strategy. The writer discusses the salient features of the above study in the present article.

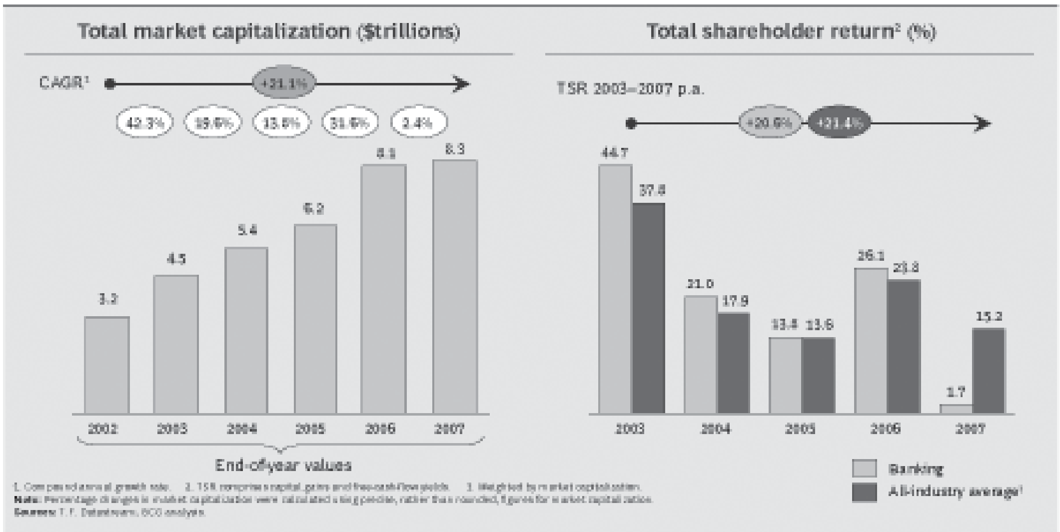
2.0 The State of the Global Banking Industry in 2007

2.1 The effect of subprime crisis on the global banking industry

Subprime mortgage crisis is an ongoing economic problem characterized by contracted liquidity in the global credit markets and banking system. It is a situation created due to subprime lending. "subprime" refers to the credit status of the borrower (being below the ideal status), and any loan that does not meet the "prime" guidelines. Subprime lending which is also named B-paper, near-paper, or second chance lending, is the practice of lending to borrowers who are not eligible to enjoy the "prime lending rates" due to their defective borrowing track records. The undervaluation of real risk in the subprime market ultimately resulted in cascades and ripple effects, affecting the world economy generally. Many banks, mortgage lenders, real estate investment trusts (REIT), and hedge funds suffered significant losses as a result of mortgage payment defaults or mortgage asset devaluation, due to subprime lending.

The global banking industry was affected by the subprime crisis severely in 2007 and faced a challenging year. The crisis was initiated in late 2006 with a sharp downturn in the US housing market, and developed into a worldwide financial crisis within a year, carrying into the first quarter of 2008. The crisis was characterized by large write-downs, weakening stock markets, and the biggest interest rate reductions by the US Federal Reserve in 25 years. The banks were unable to sustain double-digit growth, for the first time in five years. As illustrated in Exhibit 1 below, global banking market capitalization could increase only by 2.4%, to USD 8.3 trillion in 2007, a significant change from that of 2006, when growth recorded 31%, to USD 8.1 trillion. The industry's total shareholder return (TSR) or the capital gains and free-cash-flow yields, too declined sharply to 1.7% in 2007,from 26.1% in 2006 (Exhibit 1).

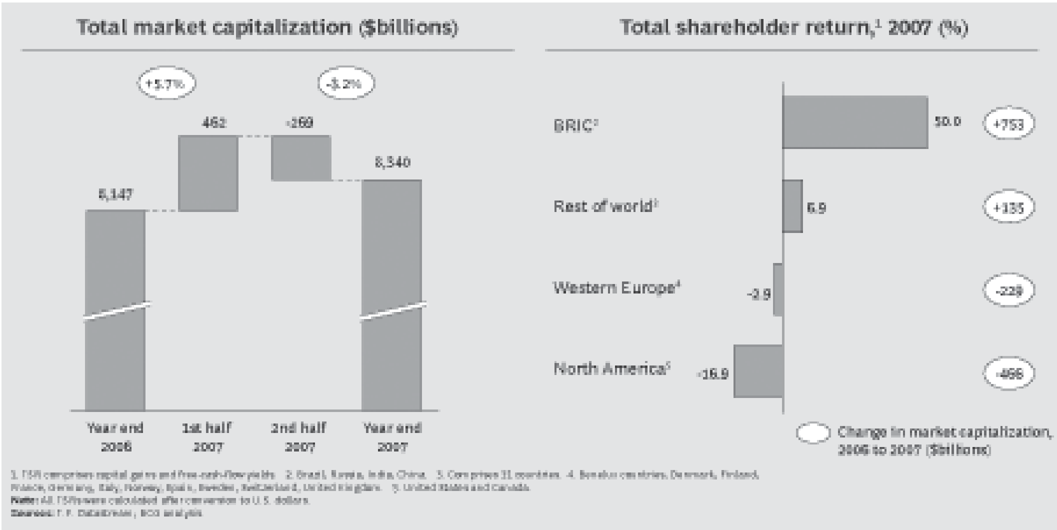
Exhibit 1 : Banks' Growth and Performance in 2007



Source : Creating Value in Banking, BCG Report March 2008, p.9

As illustrated in Exhibit 2 below, the performance of the global banking industry in 2007 indicates a decent start in the first half, from January through June, with a growth of 5.7% in banking market capitalization. However, in the second half, from July through December, banks lost USD 269 billion in market capitalization. The North American and Western European banks together accounted for a loss of USD 695 billion. However, the exceptional growth of banking industries in BRIC countries – Brazil, Russia, India and China – and other emerging markets cushioned the negative effects of the above crisis. It is important to mention that in 2007, banks in the BRIC countries recorded an increase of USD 753 billion in their collective performance, increasing their global banking market capitalization from 11% to 19%. The average banking TSR of these four countries alone was 50%. Banking TSR in all four countries remained well above the average. India's banking sector recorded the highest TSR, at 88%, while Russia and China dropped from their exceptional highs achieved in 2006. Some of the growth in banking in BRIC countries is attributed to the large IPOs of ICBC and Bank of China in 2006. At the same time, strong fundamental performance and strong revenue streams, also played a major role in the growth of BRIC banking. As a result, banks in BRIC countries achieved low cost-to-income ratios, and above-average ROEs – over 20% in Brazil and Russia (Exhibit 2).

Exhibit 2 : Global Banking Industry Performance in Market Capitalization – Year 2007



Source : Creating Value in Banking, BCG Report March 2008, p.9

The BCG study has considered 14 key industries in analysing their performance (TSR) in 2007, as illustrated in Exhibit 3 below. It indicates that the performance of the banking sector (1.7%) dropped far below the all-industry average of 15.2% in 2007. The banking industry recorded the second-largest decline in TSR among the 14 major industries in the study (more than 24% points) and its five year performance too continued to decline, relative to other industries. By 2007, the banking industry's five-year TSR had fallen to eighth place from that of fourth-best long-term TSR among the 14 industries in 2003. The subprime crisis has affected the banking industry severely. However, half of the 14 industries considered in the study too experienced a double-digit decrease in average TSR in 2007.

Exhibit 3 : Impact of the Subprime Crisis on Major Industries in 2007

Source : Creating Value in Banking, BCG Report March 2008, p.12

2.2 Performance of the global banking industry with regard to : Country, Business Segment, Market Capitalization and Banks

Country

In the study, ten developed markets have been identified from rest of the world according to their performance: United States (US), United Kingdom (UK), Japan, Canada, France, Switzerland, Australia, Spain, Italy and Germany. The findings revealed that the banking TSR in these developed markets fell by an average of about 32% points, to around -13%, well below the global banking average of 1.7%, in year 2007. It has been also noted that, banking industries outside the ten major markets have achieved a TSR of about 27%. Further, in five-year TSR, Germany has gained the first place, from a previous eighth place, with a TSR of 19.8% above-average performance, as a result of its major players having avoided the full impact of the crisis. (Exhibit 4).

Exhibit 4 : Impact of the Crisis on Banks in Major Developed Markets in 2007

Source : Creating Value in Banking, BCG Report March 2008, p.13

When considering the one-year TSR, Australia's banking industry posted the only positive result among the ten major developed markets in 2007. Its result was outstanding, with strong performance by the major banks, being totally unaffected by subprime crisis. Australia's five-year TSR too remained healthy during 2007, being able to maintain the position among the first 'best five' developed markets.

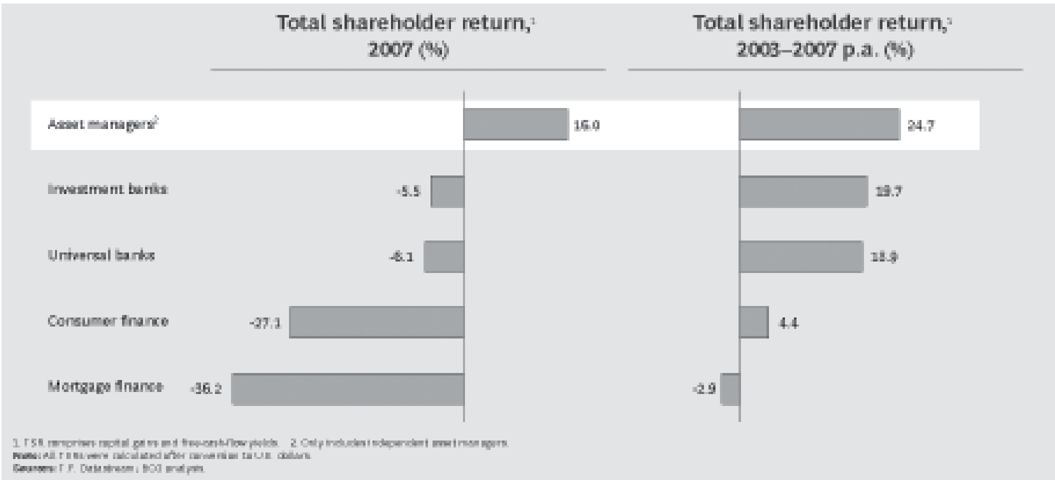
Banking sectors of Italy and Spain improved their five-year TSR rankings since 2005, by rising sharply. Italy improved its 9th place in 2005 to the 2nd place in 2007 and Spain improved its 7th place in 2005 to the 3rd place in 2007.

The lowest one-year TSR was recorded from Japan's banking industry, among the above ten developed markets in 2007(Exhibit 4). Its TSR reduced by 9.8% points in 2007, whereas banking TSR in many other developed countries fell by more than 40%. For example, US (41.8%), France (45.9%), Switzerland (43.2%) and Italy (40.0%). The net income of Japan's banking sector too declined, posing challenges.

Segment Performance

In the above research, the sample has been divided into five major segments: (1) Asset Managers, (2) Investment Banks, (3) Universal Banks, (4) Consumer Finance and (5) Mortgage Finance. Out of these five segments, only one segment – Asset Managers- posted a positive TSR in 2007. This result is in contrast to the performance of the five segments in 2006, where four segments posted positive results and only one segment – Mortgage Finance - showed a negative TSR of 2.9%. Universal Banks and Investment Banks faired much better than the Consumer Finance and Mortgage Finance segments, which has the major direct exposure to the subprime crisis in the US (Exhibit 5).

Exhibit 5 : Impact of the Crisis on Major Business Segments in 2007



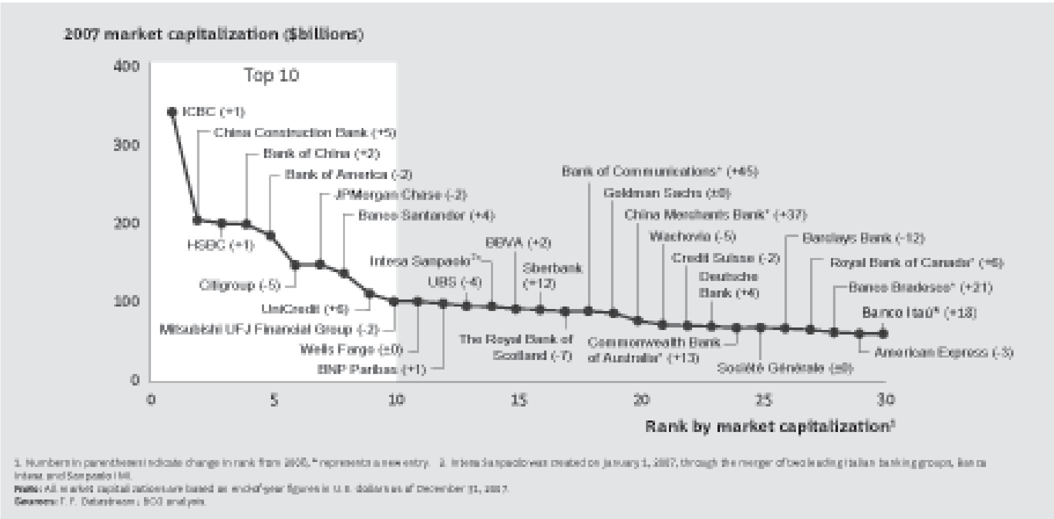
Source : Creating Value in Banking, BCG Report March 2008, p.14

In 2007, the Asset Managers had the strongest one-year (16.0%) and five-year (24.7%) TSR among the other segments in the industry. They mostly benefited by management fees, while avoiding direct losses from the security mortgage market. However, the indirect effect of the subprime crisis has caused the average TSR of Asset Managers to drop from about 24.7% in 2006 to 16% in 2007. It has been noted that investors are becoming more risk-averse and are also shifting their portfolios towards lower-margin products.

Performance by Market Capitalization

Performance of the ten largest banks in the world has been analyzed according to their performance by market capitalization. As illustrated in Exhibit 6 below, the loss of Market Capitalization was clearly evident among the world's ten largest banks in 2007. Only one bank – China's ICBC - reached the level of USD 340 billion of market capitalization, up from about USD 250 billion in 2006. This is in contrast to the situation in 2006, where three 'top ten' banks reached the market capitalization of above USD 200 billion level. The size of the market capitalization of the other banks in the 'top ten' declined by almost 20%, net effect being a drop of 4 points in the total market capitalization of the ten largest banks in the world. BCG reported that the shuffle among the 'top ten' banks in 2007 was the biggest since it began the annual studies of value creation in the banking industry, in 2003. The Chinese banking industry top the global best performers list. The three Chinese banks among the 'top ten' (ICBC, China Construction Bank and Bank of China) excelled in performance and claimed the first three slots of the top four places in 2007 (Exhibit 6).

Exhibit 6 : Change of Market Capitalization of the World's 'Top 30' Banks in 2007



Source : Creating Value in Banking, BCG Report March 2008, p.16

The increase of Market Capitalization as a whole was about 79% of the Chinese banking industry. Each of the above three Chinese banks showed remarkable performance, with high Net Profits and low Cost-to-Income ratios. Further, their Profit Earning (PE) multiples (PE multiple or the price-to-earning multiple is calculated by end market capitalization divided by the after-tax profit) ranged between 25 and 35, against the industry average of 13.6% of the global banking industry. In contrast to the above, the three largest US banks : Citi Group, Bank of America and

JP Morgan Chase indicated poor market capitalization. In 2007, Citi Group fell furthest among the 'top ten' by moving down five places, from the earlier first place to the sixth, while the other two banks also dropped by two places below the 2006 ranking (see Exhibit 6 above).

Further, two new entrants were identified in 2007 among the 'top ten' banks. UniCredit which held the 15th position in the rankings of 'top 30' banks in market capitalization in 2006, improved to the 9th position in 2007. The acquisition of Capitalia in October 2007 made UniCredit one of the biggest banks in Europe. Similarly, Banco Santander of Brazil improved its ranking from twelth position to the eighth and became one of the largest banks in Brazil, with the acquisition of ABN AMRO's local subsidiary, Banco Real in October 2007.

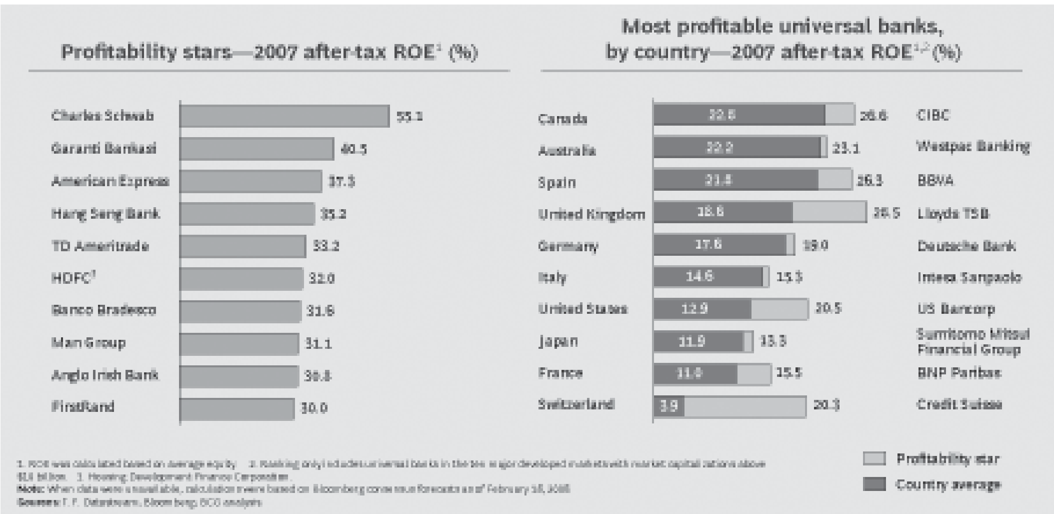
As illustrated in Exhibit 6 above, it was a noticeable move when Sberbank and Barclays bank both change rankings by 12 places in the top-30 banks list. Sberbank, being the eleventh largest bank in Europe, improved by 12 places in the above ranking, mainly due to Russia's growing consumer market and the broader economic expansion generated by rising oil prices. As a result, its market capitalization increased by 39% in 2007, to USD 91.1 billion. In contrast, Barclays bank incurred losses as a result of its exposure to the subprime crisis. Adverse performances were evident from the list of Top 30 banks in the world during 2007, due to various reasons. Subprime Crisis was a major cause among them for the poor performance of banks. Seven banks dropped out of the 'top 30' list in 2007. Three US banks in the above Top 30 banks list: Merrill Lynch, Morgan Stanley and U.S. Bank Corporation. Merrill Lynch and Morgan Stanley recorded some of the largest write-downs in 2007, connected with the subprime crisis, while US Bank Corporation was sliding down to the bottom of the Top 30 banks list. It was noted that some of the banks in the Top 30 list of 2006 had dropped off in 2007. For example, two UK banks (MBOS and Lloyds TSB) and two Japanese banks (Mizuho Financial Group and Sumitomo Mitsui Financial group) exit from the top-30 list was a remarkable event.

There were also four new entrants to the Top 30 banks list in 2007 from the BRIC countries. Bank of Communications more than doubled its market capitalization in 2007 due to newly issued A-shares and qualified to enter the above list. Similarly, the China Merchants Bank substantially increasing its net profit through a combination of rapid growth and effective cost controls, were eligible to enter the top 30 banks list in 2007. Banco Bradesco and Banco Itau are the Brazil's largest and the second-largest private-sector banks, respectively. Both banks entered the above list due to their remarkable performance in 2007. Banco Bradesco is strong in bancassurance and its retail banking targets focus on the country's low and medium income customers. Similar to most large Brazilian banks, its profits grew rapidly due to a recent surge in consumer credit. Banco Itau, which grew through a mix of acquisitions and organic strategies, mainly in domestic credit and retail operations, nearly doubled its profit in 2007, to about USD 5 billion. This was a record profit for a Brazillian bank and helped Banco Itau enter the top 30 banks in the world.

Top-Performing Banks

As illustrated in Exhibit 7 below, exceptional results have been recorded by the top-performing banks in 2007 in the average ROEs of profitability. Ten best ROEs in 2007 ranged from 30% to 55.1%, in contrast to that of 23.9% to 35.5% in 2006. Further, ten banks had ROEs of a minimum of 30% in 2007, in contrast to just one bank in 2006. It was noted that, Europe and North America no longer dominate the ranking of top performers' list. Banks from emerging markets recorded some of the best ROEs in 2007. Garanti Bankasi in Turkey (increased its interest income by 44% in 2007, mainly from loans, securities and leasing business), Banco Bradesco in Brazil (net income increased by 59% in 2007), Housing Development Fnance Corporation (HDFC) in India (increased its interest income by 40% in 2007 through interest income and sale of investments), Hang Seng bank in Hong Kong (increased its net profit by 43% in 2007 as result of wealth management and fee income) are few examples. However, it is a remarkable move when a U.S. bank, Charles Schwab, topped the ROE ranking with an exceptional ROE of 55.1% in 2007. The performance of this bank has been driven by its limited exposure to the subprime crisis and a large restructuring move resulted in a leaner capital structure.

Exhibit 7 : Profitability Stars of 2007

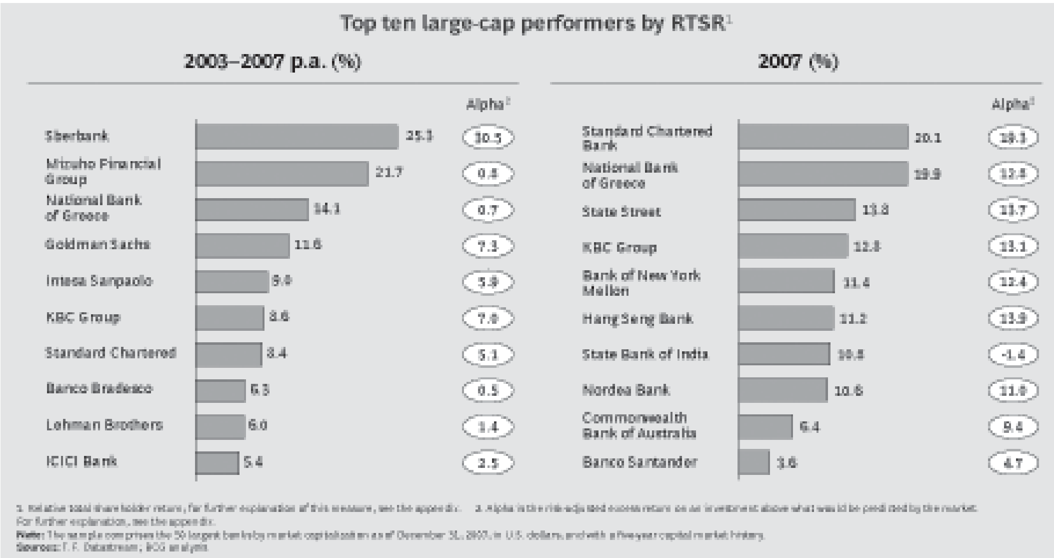


Source : Creating Value in Banking, BCG Report March 2008, p.19

Further, when considering the profitable universal-banking sectors, Canada had the strongest universal banks, measured by an average ROE. CIBC, its best performer recorded an ROE of 26.6% . Australia and Spain qualified for the top three positions in the Universal Banking sector. Spain moved from sixth to the third and Australia from third to the second, due to their Universal Banks continuing their track records of strong performance in 2007. These two countries also had the three highest overall banking TSR in 2007, being least affected by the subprime crisis in the US market. Switzerland's universal banking sector fell to the tenth position in 2007, due to their poor performance.

Large Caps : the group of top performers in the global banking industry has been ranked by the Relative Total Shareholder Return (RTSR). It adjusts TSR for local market influence. It was noted that the top performers according to the RTSR ranking was geographically diverse. As illustrated in Exhibit 8 below, there are only two US banks among the ten best RTSR performers from 2003 to 2007 (Goldman Sachs and Lehman Brothers). Similarly, there are only two US banks among the ten best one-year RTSR performers (State Street and Bank of New York Mellon). Other highflyers were from Australia, Europe, Japan, and emerging markets like India. Further, State Bank of India was the only large-cap bank in the top-ten RTSR ranking with a negative alpha, which means its investors did not receive an adequate return for the risks they have undertaken. Individual risk-adjusted performance relative to the local market is indicated by alpha. Positive alpha values signifies excess returns of the stocks and small or negative alpha values signifies underperformance of the stocks. Exhibit 8 below illustrates further the Large-cap top performers in the global banking industry.

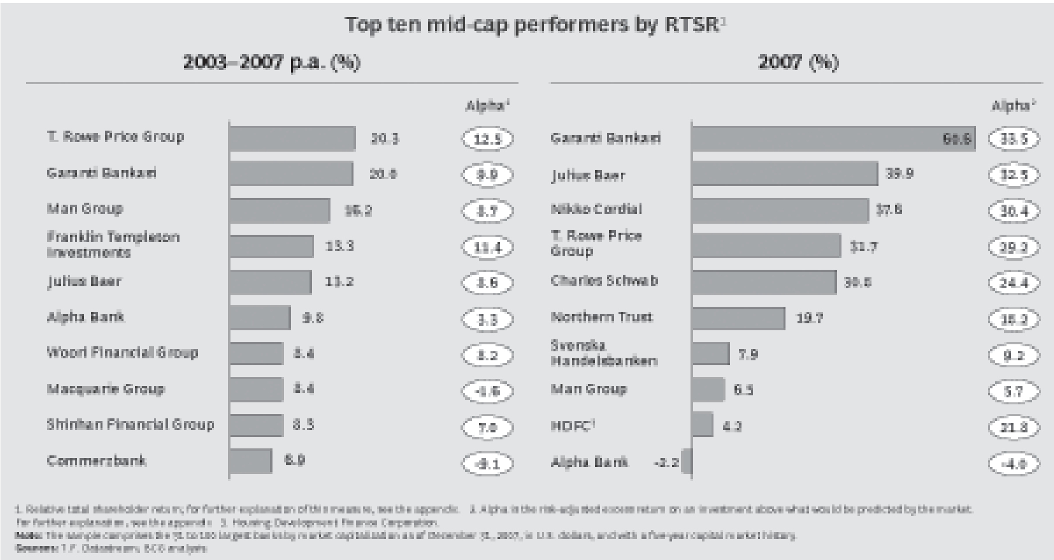
Exhibit 8 : Top Ten Large-Cap Performers in the Global Banking Industry – 2007



Source : Creating Value in Banking, BCG Report March 2008, p.20

Mid-caps : It was noted that Asset Managers were prevalent in the five-year RTSR ranking. T.Rower Price Group, Man group and Franklin Templetion Investments were able to claim three of the top four positions in the long-term RTSR ranking. The five best long-term RTSR performers all had high positive alphas while two of the banks with strong long-term RTSR recorded negative alphas. They are Macquarie group and Commerzbank (German banking sector) which had the highest five-year TSR, but negative alphas due to volatile stocks and their performance was not commensurate with the risk. One-year RTSR ranking was topped by Garanti Bankasi with an outstanding ROE of about 40%. It had a high alpha that indicates it significantly outperformed the Turkish stock market. Alpa bank recorded a negative alpha due to high volatility in the stock and a strong Greek stock market performance (Exhibit 9).

Exhibit 9 : Mid-cap Top Performers in the Global Banking Industry - 2007



Source : Creating Value in Banking, BCG Report March 2008, p.20

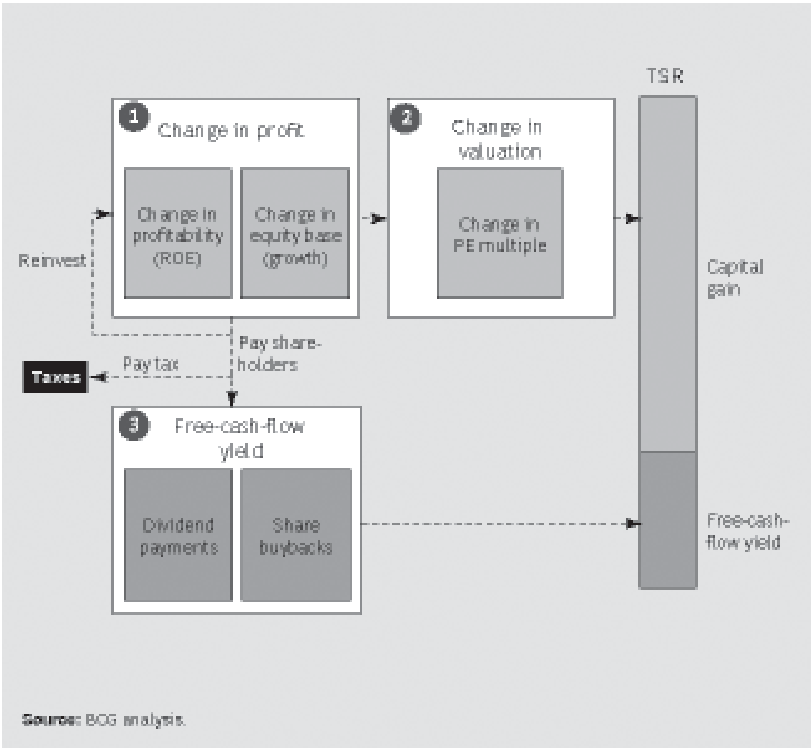
The outcome of the BCG study revealed that, one-and five-year RTSR rankings reflected broader trends in the global banking sector. As discussed above, the ten best large-cap performers were diversified and also included banks from emerging markets, such as India. Further, the Asset Managers, which had only direct exposure to the crisis, were outstanding among the best mid-cap performers.

3.0 Understanding the Drivers of Value Creation

It is crucial to understand the drivers of value creation in the banking industry, especially during turbulent times. The BCG's study of value creation in the banking industry 2008, quantifies the impact of three TSR drivers, namely: (i) profit growth, (ii) change in valuation and (iii) free cash-flow yield. In the above analysis, the profit growth is determined by the change in a bank's profitability (which is measured as return on equity or the ROE) and the Equity base. A bank's valuation is considered as the function of its PE multiple and its free-cash-flow yield is a reflection of dividend payment and share buybacks.

BCG's study analyses a bank's TSR under the above three elements and suggests it creates an understanding as to the nature of the drivers that determine a bank's value-creation performance. Exhibit 10 below illustrates the composition of the TSR under the above three main drivers.

Exhibit 10 : Composition of TSR into three main drivers



Source : Creating Value in Banking, BCG Report March 2008, p.22

Further analysis of the above BCG's study revealed that, the equity growth continued to make the major contribution to banks' TSR in the long-run. It has been continuously growing over the past few years and contributing towards the banks' five-year TSR. This trend has continued in 2007 as well. 'Growth' is crucial and is the central theme in the banking strategy, as evidenced by the 'emerging giants' among the world's largest banks, unexpected shake-ups of the market-cap rankings, and the current consolidation activities in the global banking arena in 2007, as discussed above. It was noted that, in the above study the growth does not always translate directly into positive value creation. There have been incidents with high rates of equity growth, there have also been significant share dilutions and declines in PE multiples in the global banking industry. It has been also reported that, ROE improvements make only a small contribution towards banks' long-term TSR. The investors confidence has remained the only negative driver of the long-term TSR in the banking industry. Finally in the long-run, improved profitability has distinguished the top performers from the rest of players in the global banking sector. The star performers have increased their profits through a balanced mix of ROE and equity growth. They have distinguished themselves from the other players in the industry, mainly by increasing ROE well above the average. (their change in ROE, at 24.3%, was nearly six times as high as the industry average).

In analysing the short-term performance of the global banking industry, the study revealed that global banks' average TSR had dropped by 27.7 percentage points in 2007, mainly due to the decline in profitability. ROE had declined by 28.5% in 2007 and this was the only negative value among the drivers of TSR. Equity growth weakened, but remained positive at 12.7%.The industry's steady, increasing profits came to an abrupt end in 2007. The industry's ROE decreased by 4.5 percentage points, to 13.0%, due to massive write-downs in Western Banks. The investors were more optimistic and the average PE multiple increased to 13.6 in 2007. It was reported that, the TSR contribution of share buybacks and dividend payouts doubled, to 5.5%. The sub-prime crisis affected the liquidity and forced banks to raise capital. Some banks had no choice but to decrease both share buybacks and dividend payments. This had helped the other banks to increase their payouts substantially. Further, the study revealed that in 2007, the banks, in general, were more active in managing their free-cash-flow yield.

4.0 Placing TSR at the Centre of Corporate Strategy

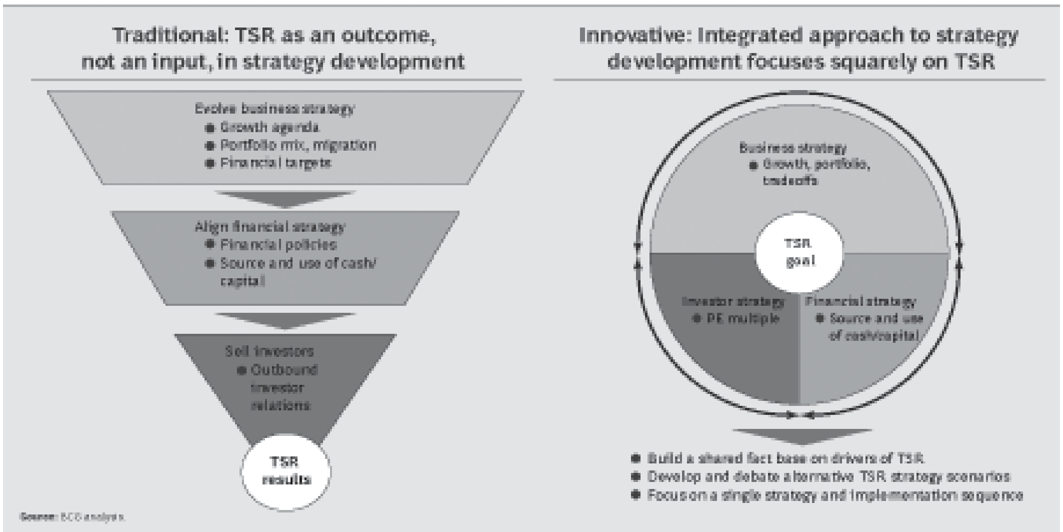
The study highlighted the state of the global banking industry in 2007, focusing on the effect of subprime crisis on banks' growth and performance, market capitalization, business segments, country/developed markets etc. It discussed how the crisis began in the latter part of 2006 with a sharp down-turn in the US market due to subprime lending and developed into a global financial crisis within a year. The BCG study revealed how total shareholder return or TSR could be used at the centre of a company's business strategy, in order to create value during turbulent times.

With low PE multiples and growth strategies unable to increase TSR, the global banking industry is faced with a major challenge in finding the correct pathway to deliver superior TSR. The current crisis faced by the global banks has underlined the urgency of renewing their corporate strategies for delivering superior TSR. The study recommends, that banks need to follow how leading companies target at superior TSR results. Accordingly, to ensure strong TSR in turbulent times, the banks need to follow an integrated approach that addresses three key areas: (1) explicit value-creation goals that integrate business strategies; (2) financial policies/strategies; and (3) investor considerations/strategies in their long-term plans. The BCG study reveals how such an integrated approach differs from the norm, where everything flows from management's vision for business strategy, or follows a 'top-down' method, which might encompass an ideal portfolio mix.

In the above approach, the bank's financial strategy, investor strategy and TSR performance are all considered as 'outputs' of the business strategy, rather than 'inputs'. BCG argues, in this approach, a bank's business strategy will rarely generate superior TSR. The bank's best-laid business strategies can be supported by suboptimal financial strategies and are always subject to the interpretation of the capital market. The investors may have a different view on the value-creation potential of the bank's business strategy and may react negatively to the financial strategy, having the last word on the strategy's impact on TSR.

The BCG's study introduces an alternative to the above traditional approach and it re-defines the 'centre of the universe' for strategy development. In this approach TSR goal is used as the main driver of management thinking, rather than a business strategy vision. This change of order of priorities underestimate the notion that superior TSR (not market-cap size, market share, growth, or a particular portfolio mix) should be the bank's main goal. Further it recognizes that, before a business strategy has been decided upon, business strategy choices need to be informed by financial and investor strategy. Exhibit 11 below further explains the above two approaches.

Exhibit 11 : Traditional and Innovative Positions of TSR at Strategy Development Process



Source : Creating Value in Banking, BCG Report March 2008, p.28

5.0 Key Findings of the Study and Recommendations

Based on their study on "managing shareholder value in turbulent times", BCG has recommended that four steps are essential to developing an integrated value creation strategy in a bank. The researchers have identified the banks that follow these steps and have often been surprised by the results. For example, the banks have experienced a disconnect between the business strategies and their TSR goals. In addition, the banks have also gained a good control over their value-creation goals, as a result of following these four steps. The four-step process is discussed below in brief and further illustrated by Exhibit 12.

5.1 Four-step Integrated Value Creation Strategy

Developing an integrated strategy to create superior value (TSR) is crucial for the banks, especially during turbulent times. In a time where all the usual business/financial/investor strategies do not work as scheduled, it is essential to turn to a different strategy, where many banks in the past have gained positive results. The above four step process is discussed below.

Step One : To facilitate an open, honest discussion about the bank's TSR goals

This process is crucial for three reasons: to bring the management team around a common purpose before beginning the process; To place TSR at the centre of the planning process and to reveal how well the executive team understands the most important drivers of TSR for the bank. The following has been recommended in order to make the most use of the above process.

- Engage the right mix of executives – small discussion group with 5 to 7 individuals
- Provide historical and prospective facts about TSR to the group
- Forge agreement on both the time frame for achieving the target of TSR and the bank's relevant peer group
- Ensure open and honest discussions among the group

Step Two : To develop a comprehensive 'fact base' on the drivers of TSR

Members of the group will have many different opinions about how to improve performance of the bank, but all the opinions cannot be correct. To avoid such situation, six questions have been prepared to aim at the real drivers of TSR for a bank, as follows:

1. What are the drivers of the PE multiple in our peer group ?
2. Who owns our stock, and what are their priorities and expectations ?
3. How does divestiture affect TSR?
4. How do financial policies affect TSR?
5. What is the implied TSR of our Corporate Plan?
6. How does each business unit contribute to that TSR?

Answers to the above first four questions will help:

- To provide a capital-markets-behaviour perspective on the key drivers of TSR, involving sophistication, behaviour, and priorities of capital markets. BCG suggests that by developing an up-to-date fact base on these areas will help the executive team ensure that their views are fully informed and help to make the best decisions about how to prioritize and select the right TSR strategy.

- Answers to the first four questions will help the banks to address the last two questions. A genuine opinion of the impact on TSR of the company's plan often results in one of three realizations.- i.e. First - a common outcome is that the plan creates a high TSR on paper, but not practically achievable, since most of the three-to-five year plans are purely visionary than practical. Second - the plan's projected TSR is below executives' aspirations. Third – the plan delivers a good TSR, but lacks balance. It is believed that most of the value is created in the first year, for example, while TSR in subsequent years is weak.

BCG study suggests that by paying more attention to capital market considerations, eg. Investor mix, financial strategies, drivers of the PE multiple etc., banks can reduce the gap between their TSR plans and aspirations. Further, in general, even more value can be generated by assessing the contributions of the business units to TSR, by using ROE to gauge the performance of business units. However, it is important to note that, different businesses can have different PE multiples, which could influence how banks allocate resources. BCG suggests that instead, banks should examine business unit roles, priorities, and resource allocations, as well as the overall portfolio mix. However, the insights that emerge from this perspective differ from those that are based on traditional metrics, such as, ROE or economic profit, and will lead to a better allocation of resources, a clearer definition of business unit roles in driving TSR, and more suitable short-term and long-term targets for each business unit.

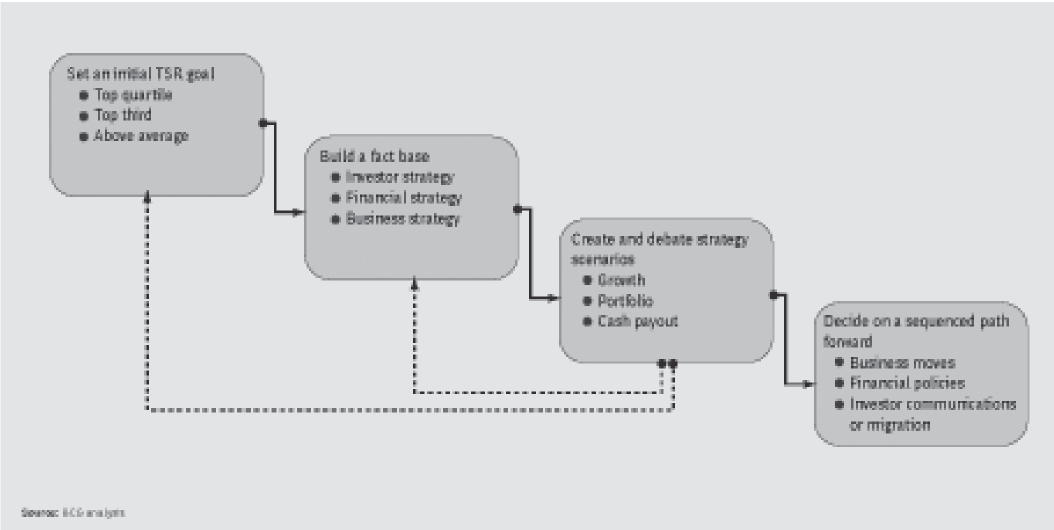
Step Three : To develop and debate a range of integrated TSR strategies. This step is a combination of the perspectives developed in step one with the insights from step two which leads to three to five paths for achieving strong TSR. Each path will have its own priorities and tradeoffs across business-strategy initiatives, financial-policy opportunities/constraints, and investor-strategy issues. Further, they will also vary in their levels of risk and TSR outcomes, their short-term and long-term results, their suitable investor mix etc.

The banks will share a common basis, as much as these strategies may diverge. i.e the alignment of internal beliefs, comprehensive facts, and a goal of delivering superior TSR. This comes as a refreshing change in many banks. Further, it is noted that the banks' value-creation plans are often disrupted by internal tensions or competing views among the banks' corporate executives, line-managers and board members.

Step Four : To gather around an agreed-upon strategy and sequence it for maximum impact. It has been noted that, delivering superior TSR consistently is a difficult task. There are no simple processes found for this challenge. However, best TSR strategies could be found over a three-to-five year time period. BCG suggests that they may emphasize cash payouts or ROE improvements in the first years but, migrate towards higher growth in latter years – or vice versa.

Finally it is noted that, generally, an integrated value-creation strategy will help the banks to be in a much better position to achieve superior TSR. It is also noted that banks usually find that they have a greater control over their value-creation destiny, once they avoid looking at their TSR as a by-product of their business strategy. The BCG's study recommends the above four steps to the global banking industry to develop an integrated strategy to achieve superior TSR in turbulent times.

Exhibit 12 : Four-Step Process of an Integrated Strategy to Achieve TSR in Banks



Source : Creating Value in Banking, BCG Report March 2008, p.29

6.0 Conclusion

This article which is based on a recent study conducted by the Boston Consulting Group, USA in March 2008 on 'Creating Value in Banking: Managing Shareholder Value in Turbulent Times', dwelt on the state of the global banking industry in 2007. The article focused on the effect of subprime crisis on banks' growth and performance, market capitalization, business segments, country, developed markets etc. Subprime crisis, created by subprime lending which arose by late 2006 with the down turn of the US housing market, expanded into a global crisis within a year and carried into the first quarter of 2008. It affected the banks' growth and performance in 2007 severely, reducing same to far below the industry average. It weighted heavily on banks in major developed markets and also affected many business sectors, in addition to the banking industry.

As a result, the rankings of the 'top ten' major banks in the world changed drastically. There were many drop-outs as well as new entrants to the list. Further, the list of 'top 30' banks in the world too registered many changes in 2007, as a result of the crisis. The performance of BRIC-countries in 2007 was highlighted as an exception to this behaviour of the banks in the rest of the world. However, it was also noted that there were several emerging market banks among the most profitable banks in 2007. Further, when considering large-cap performers in 2007, it was noted that they emerged from different corners of the world. The above situation highlights the importance of finding an effective solution to achieve superior TSR in the global banking industry.

Analyzing the above situation in 2007, it recommended at understanding of the drivers of value creation by decomposing TSR into three main drivers : profit growth; change in valuation and free cash-flow yield, and quantifying the impact of same. Further, it is important to place TSR at the centre of the bank's corporate strategy, in order to show how total shareholder return or TSR could be used to create value during turbulent times. Developing an integrated strategy to create superior value (TSR) is crucial for banks during turbulent times, since the usual business/ financial/investor strategies may not work as planned. Therefore, it is essential to turn to a different strategy, where many high performing banks have gained positive results in the past. Finally, a four-step process has been recommended in developing an integrated strategy to achieve superior TSR, in order to face the challenge of short-term as well as long-term shareholder value creation in the global banking industry during turbulent times.

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