The Norwegian Financial Services Industry

Contents

The Norwegian Financial Services Industry

Introduction

International banking and financial services have been characterized by extensive structural changes for a long period of time. Globalisation, liberalisation, and new technology are the driving forces of an evolution towards enhanced competition based on increasingly harmonious regulations. This has resulted in the formation of international finance enterprises, which operate across frontiers and former business sectors. The insertion of the euro intensifies the competition further, and amplifies the pressure to erase overcapacity in the industry. Change will be the normal condition for the future financial services industry.

The government participation in the Norwegian financial services industry is comprehensive. The development in Norway has gone in the opposite direction of the international trend characterised by privatisation and market orientation of state managed business activity, which may be disadvantageous for the structural development of the Norwegian financial services.

Commercial banks and savings banks

There are two different types of banks in Norway, savings banks and commercial banks. Traditionally, the savings banks where banks for private individuals, while the commercial banks focused on industry and commerce customers. Today, most of the banks focus on both private individuals and business customers, and offer services like loans, deposits, investment management, trading/arbitrage, payment services, financial advisory services, foreign currency- and capital market products, and different insurance services. The difference between the two types of banks is mainly the ownership structures. Stockholders own the commercial banks; it is joint-stock corporations. The Norwegian savings banks have certain fundamental features in common and their profile is different from the commercial banks. A fundamental aspect is the idea of cooperation between independent units. The savings banks have a common identity that emphasizes closeness to customers, local roots and responsibility.

The savings banks in Norway are organized as independent foundations, i.e. there are no stockholders or traditional owners of the assets that the bank have. Nor is anyone entitled to any share of the savings banks' profits. The savings banks' net capital mainly consists of profits from previous years that are ascribed to the banks' funds. However, in the eighties the savings bank where also entitled to draw net capital from the market by call for primary capital certificates[1].

There are 130 savings banks in Norway, a number that has been substantially reduced from more than 600 in the late sixties. The reduction is due to mergers of savings banks to

[1] The primary capital certificates are securities with many similarities to shares. The main difference is that such certificates do not give property rights to the company worth in the issued savings bank. The primary capital certificates have become an important part of the savings banks' capital base, constituting approximately 23 percent of the total capital base [01.01.2000].

form larger, more powerful units, a tendency that has become weaker during the last years. The larger regional savings banks represent a major share of savings banks' aggregate total assets. The 15 largest savings banks represent more than 75 per cent of the total assets in the savings banks industry.

During the last decade the savings banks have established a comprehensive cooperation in technological services and other financial services in order to achieve economies of scale. Today, all the savings banks are more or less tied to one of three distinct groupings in the sector. The largest group when it comes to total assets is the Union Bank of Norway (Sparebanken NOR) and its associated savings banks. The second group, SpareBank 1 Gruppen, consists of four large regional savings banks and several other medium-sized banks. The third group consists of around 80 small and medium-sized savings banks, and is called Terragroup.

In the private consumer market the savings banks have the largest market share in both savings and loans. Traditionally, savings banks have been regarded as banks for the private consumer, but throughout the 90's the savings banks have increased their market shares in the commercial sector, especially in the SME-market.

Major actors in the Norwegian financial market

During a critical financial period for the banks in the eighties, many questions regarding commercial structures in the Norwegian financial industry where solved. We got two major savings bank groupings, Sparebanken NOR and Sparebanken 1 Gruppen. The two archrivals Den Norske Creditbank and Bergen Bank grudgingly became Den norske Bank and Svenska Handelsbanken established itself in Norway. Fokus Bank has later become Danish. The newly restructured banks then merged with insurance. Vital became part of Den norske Bank, Storebrand established its own bank, and Gjensidige and Sparebanken NOR became Gjensidige NOR. Den norske Bank has recently absorbed Postbanken whilst Christiania Bank og Kreditkasse has merged with Merita Nordbanken and UniBank in Denmark to become the Nordic banking group NORDEA.

The result of all the mergers is a financial services industry with a good balanced competitive structure with two to four powerful players in most segments of the market.

The ten biggest banks in Norway based on total assets value. (December 1999)	
Den Norske Bank	313339 (NOK million)
Kreditkassen	210817 (NOK million)
Sparebanken NOR	196356 (NOK million)
Fokus Bank	44314 (NOK million)
Sparebank 1 SR-Bank	36397 (NOK million)
Sparebank 1 Nord-Norge	28615 (NOK million)
BN bank	27459 (NOK million)
Sparebank 1 Midt-Norge	26373 (NOK million)
Sparebank 1 Vest	26255 (NOK million)
Svenska Handelsbanken	26108 (NOK million)

Source: Norwegian Financial Services Association (FNH).

On a consolidated basis the commercial banks recorded a profit before taxes of NOK 8 billion in 2000. This is an improvement of 11 percent compared to 1999, and corresponds to around 1,12 percent of average total assets. The saving banks recorded an operating profit of NOK 9,5 billion before taxes on a parent company basis in 2000, which was 1,81 percent of average total assets, and an improvement of NOK 1,3 billion compared to 1999.

For both commercial banks and savings banks the return on equity at the end of 1999 was around 15 per cent (converted to annual basis).

Savings and investment management

This report will focus on mutual funds as a savings service in the Norwegian bank sector. The size of the entire savings market of the OECD countries currently measures roughly US$35tr. These assets are managed by insurance companies, mutual fund groups, pension funds, and other institutional providers of long-term savings vehicles. The overall level of annual inflows into this whole arena currently exceeds US$3tr. Between 1990 and 1998, the compound average growth rate of these assets equalled 12 per cent, and this growth is expected to continue.

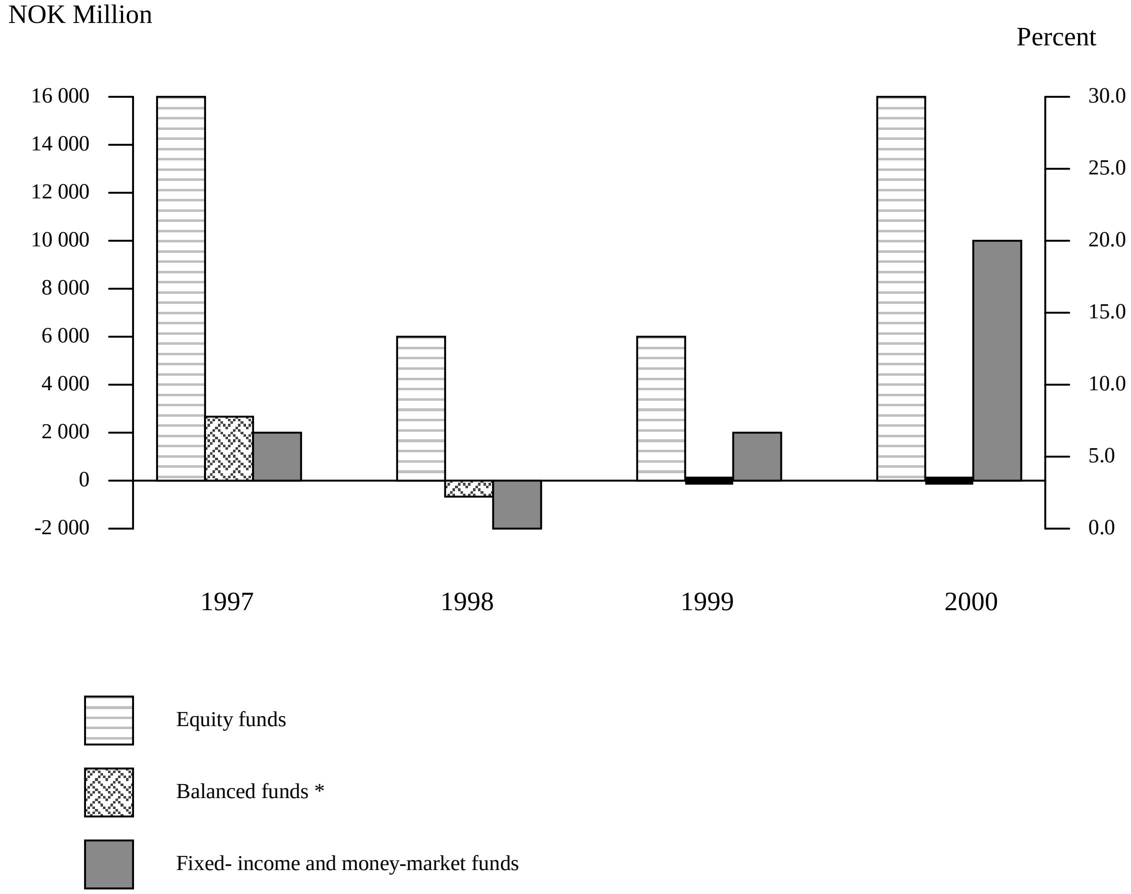

Figure 1: Total Norwegian mutual fund market, net new subscriptions

* *A balanced mutual fund is a fund composed of both a variety of common stocks (equities) and fixed income securities (debt instruments such as bonds and debentures). The objective of this type of investment is to minimize the risk without sacrificing the possibilities of long-term growth. These funds invest their money in specified proportions, in fixed income securities, and common stocks. For example, the fund may limit its investments to 60% debt and 40% equities. As a result, it does not show as large a gain during a rising market as do most common stocks. On the other hand, it will usually suffer fewer losses in a declining market.*

The combat of people's savings is getting tougher. The combination of a general increase in prosperity and an ageing population that focus more on saving than younger people, have contributed to increase the part of banks' deposits and deposit capital related to savings. Particularly saving by shares- and mutual funds investment has experienced a large growth in resent years, and the internationalisation of financial services has resulted in an expansion of financial institutions' activities related to investment services.

New technology – online services

The financial services business has undergone major restructuring the last decade, yet this process has just begun. The Internet has major influence on financial services and shows every sign of becoming the distribution channel across all product categories and business models over the next decade.

The industry is one of the most open and most technology-driven information-based businesses we have, thus electronic services within commerce and finance are regarded as one of the big growth areas in the years ahead. The great challenge for financial companies is to find their place in the new global world of electronic commerce. While some smaller and specialized firms may focus on any one of the financial verticals, the future for large-scale retail financial service providers is to offer a web-based hub that will include a complete range of products and services.

An increasing proportion of the managed savings market is expected to move online. According to a survey conducted in Germany by Forit[2], equity brokerage, current account maintenance and fund brokerage are likely to be the next popular online products.
In line with consumer's demands, it appears that mutual funds are the next asset to move online. The European mutual funds market is characterized by the dominant position banks enjoy both in terms of production and distribution. The use of Internet as a distribution channel for mutual funds varies by country. Overall, it is estimated that 1 % of sales are made online. The proportion of funds sold online is greatest in Scandinavia; Swedbank indicated that it processed 20 % of the mutual funds total order flow online in the first half of 2000. The Scandinavian mutual fund market, estimated to 173bn euro at the end of the first quarter of 2000, is dominated by the banks in the region. Eight out of the ten largest players and all of the five largest are banks. In Scandinavia, as well as in other European markets, it is expected that the proportion of funds sold online will increase. This is because the medium is a very good one for analysing fund performance and subsequently selecting funds, and the transaction is relatively easy to execute. In the US, the Internet is already making significant inroads in mutual fund distribution; 9 % of the US mutual-fund-owning households conducted a mutual fund transaction via the Internet in the 12 months to March 2000. As opposed to the European distribution model, fee-based intermediaries and fund supermarkets, both of which are pure mediators, are breaking up the value chain in the US mutual funds market. The bulk of US Internet mutual fund distribution goes through such intermediaries rather than directly through the provider's website; 36 percent of mutual fund share holders who conducted a transaction via the Internet in 2000 own funds through an online-only broker. This is also expected to be the case in Europe, as fund supermarkets are beginning to emerge.

The financial services in the future must be an integral part of the new Internet economy, which calls for the swift creation of value added services. This means heavy emphasis on the development of expertise and new technology. Customer relations will also become more important in a world where global competition challenges customer loyalties in every dimension. Multiplicity is becoming more important than imitation, differentiation is becoming more important than size, and strong branding and reputation is becoming important competitive parameters.

[2] Credit Suisse First Boston [Europe] LTD., 2000: *Asset gathering in the new economy*.

Structural changes

The structure of financial services will change in the future, and the industry's structural contour will be erased as a result of establishment of competitive bridges to different services and industries. The financial services industry is moving towards simpler and more decentralised structures, provided that one is able to make use of the new information and communication technology. It is unlikely that the major traditional banks will be at the forefront of the technological development. The challenge will rather be whether the financial companies are able to acquire the new skills that the Internet economy represents. Perhaps will we be witnessing mergers between banks and innovative Internet companies. A new trend that might appear is a shift in industry demarcations through the arrival and involvement of aggressive players from telecommunications and IT-sectors in the financial services industry.

The industry is characterized by an inclination towards increased horizontal integration over a broad spectrum of financial services, which results in the formation of large financial enterprises. This is mainly caused by the opportunities for realization of economies of scope through joint production of services within the same business economic entity, strengthened by consumers desire to buy certain financial services like bundled products in order to save transaction costs. Related to this horizontal integration, vertical disintegration processes in the distribution chain due to new intermediaries are taking place as well. The horizontal integration capabilities of these intermediaries may lead to increased concentration in the financial markets.

On the other hand, there are tendencies towards diversification of the available product spectre, beyond the financial services, and establishment of conglomerates[3]. The driving force behind this trend is the convergence of different markets as a consequence of a common technological platform or infrastructure to offer products, caused by technological development. Typically, this infrastructure consists of different physical networks that are connected; like computer networks, telecommunication networks, broadcasting networks, electricity networks, etc. This implies that corporations connected to such networks have the opportunity to offer all kinds of products and services that can be transferred through these networks. Thus, the biggest challenge for the "traditional" financial corporations is to cope with the competition from new none-financial actors that will offer financial services, provide market positions in the new electronic financial markets, and to adapt one's strategic market- and structural thinking to conglomerate formations.

[3] An example that may illustrate this is that Den norske Bank offers financial services through the branches of Norway Post.

Value Chain Description

The objective of this stage is to provide a detailed description of the value chain structure in the financial services industry. More specifically, the description will mainly focus on the distribution channel in mutual funds' value chain. Each link of the chain will be discussed in brief, thus making it possible to gain insight in the different value chain components and the relations pertaining to each part.

Mutual funds value chain

In the European financial services industry, the current business model depends on a vertically integrated value chain through which multiple products are originated, packaged, sold, and cross-sold through proprietary distribution channels. The distribution model for mutual fund in Europe is characterized by proprietary sales forces, which account for the majority of funds sales.

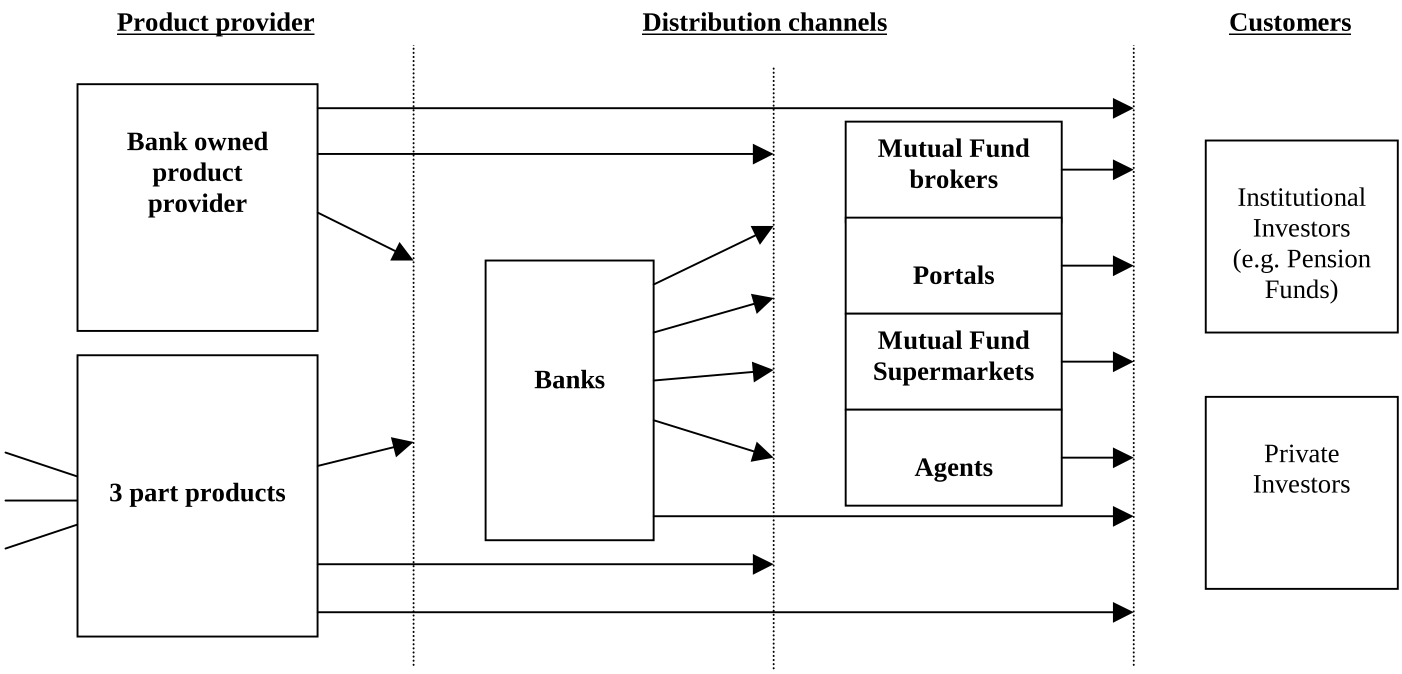

Figure 2: Mutual funds value chain.

- mutual fund providers

The European mutual funds market is characterized by the dominant position banks enjoy both in terms of production and distribution. On the production side of the industry, banks have a share in excess of 90 % in most key markets outside the UK (Source: Credit Suisse First Boston, 2000).

- distribution channels

In Scandinavia, the bank branches have been the dominant intermediaries in the mutual fund market. The banks have shares ranging from 53 percent to 96 percent of mutual fund distribution in Europe[4].

Traditionally, financial services products have been sold or distributed through 1) companies' own agents, which are agents of financial services companies, or the branches of a bank for bank-owned products. (These can range from traditional banking products, such as deposits, loans, and payments, to other financial services products, such as life insurance, pensions, and mutual funds.) 2) Independent agents, which are the independent financial advisers in the UK, broker/dealers in the US, or the growing group of brokers in Continental Europe. They also include banks that sell on behalf of third-party insurance companies, mutual fund groups or other financial services companies. 3) Direct sales, where the financial services product is purchased directly from the provider at the behest of the customer.

In a web environment, the technology should soon exist to compare the products of all similar financial services products, and be able to affect the sale of these products. The need to have a financial services affiliation starts to become less compelling in this environment, thus the use of independent agents may increase. However, the banks' response to the challenge related to the emergence of the Internet as a distribution channel, has been to make sure that their own Internet distribution is up to the standards of their competitors. Despite some analysts' argument that banks are not cut out to be financial portals, many are developing their sites with the vision of becoming more than a dead end for account management and transactions. Further, in a web environment, many financial services companies are already endeavouring to build up their direct sales functions. Similar to the old economy, the products are purchased directly from the financial services provider at the behest of the customer. The increased sophistication on the part of the customer is shifting the emphasis away from distribution in favour of product characteristics such as performance. The banks response to this challenge has been to open up their distribution networks, either partly or fully to the products of third-party providers.

With thousands of mutual funds for sale, most investors need some help separating the prime funds from the rest of the herd. The broker has the ability to provide information and access to a wide range of mutual funds. Just as important as providing advice is the online broker's ability to provide a consolidated mutual fund center, since the average investor owns funds from several different mutual fund companies. In this instance, the Internet does add value, by creating a readily accessible one-stop destination for mutual funds. In the US, where this Internet already is making significant inroads in mutual fund distribution, the bulk of this distribution goes through such intermediary mutual fund supermarkets rather than directly

[4] Source: Credit Suisse First Boston, 2000.

through the provider’s web site. (36 % of mutual fund shareholders who conducted a transaction via the Internet in 2000 own funds through an online-only broker.)

Most financial portals features tools like portfolio tracking, emailed news, price target alerts, and some variety of wholesaled news and/or original content. Most of the value add in the portals are the portfolio analytical services and topical articles. Most are advertising supported models with some ability to pay a subscription, essentially wholesaling other feeds.

Potential reconfigurations in the financial services industry

The use of the Internet as a distribution channel for mutual funds varies by country. Overall, Credit Suisse First Boston (2000) estimates that 1 % of sales are made online, and expects this share to increase. In the new world, distribution can be done by the phone company, statements by financial management software, facilitation by different kinds of agent software, and origination by any number of different kinds of product specialists. The integrated value chain of retail banking will thus have been deconstructed. However, banks would not become obsolete, but their current business definition would change – specifically, the concept that a bank is a vertically integrated business where products are originated, packaged, sold, and cross-sold through p roprietary distribution channels.

Because of the Internet, customers can access information and make transactions in a variety of new ways. In today’s integrated business model, the retail bank stands between the customer and the full range of financial services. But through Internet technologies, customers will have direct access to product providers. As choices proliferate, totally new businesses will arise to help customers navigate through the expanded range of banking options (e.g. mutual fund supermarkets). Thus, some companies will have an incentive to create (or simply make available) databases on interest rates, risk ratings, and service histories.

Case study presentation: Den norske Bank

Background Information

The DnB Group is, with its 7052 employees (full time positions at the end of year 2000), 2,1 million retail customers and 104000 business customers, the largest institution in the Norwegian financial services industry and the main bank connection for the major part of the 300 largest businesses in Norway. DnB has a total group asset of NOK 452bn (US$49bn), and it is the 3rd largest market cap on Oslo Stock Exchange (Oslo Børs). Presently, the government owns 60,64 percent of DnB.

In 2000, DnB made an annual profit of NOK 4018 million, which was an increase of 29 per cent related to the profit for 1999 (NOK 3125 million[5]). The net interest income for 2000 amounted to NOK 7221 million, which was an increase of NOK 140 million compared to the 1999 numbers. The pre-tax operating profit before losses was NOK 5012 million in 2000, and NOK 3608 million in 1999, while the pre-tax operating profit for 2000 amounted to NOK 5248 million, compared to NOK 3636 million in 1999.

- Concern structure

DnB Holding is the stock exchange listed parent company of the group of companies that form the DnB Group. Den norske Bank ASA (which will be in focus in this study), Vital Forsikring ASA, DnB Kapitalforvaltning ASA, Vital Fondsforsikring ASA, and Vital Skade ASA are all associated companies in this structure (figure 3). DnB Holding is concerned with superior subjects and tasks in the concern, e.g. planning, risk governance, and questions regarding capital structure.

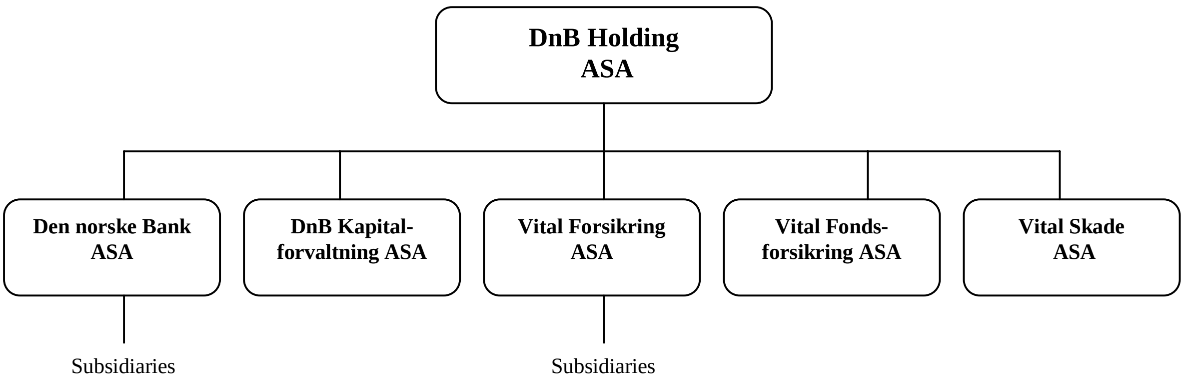

Figure 3: Structure of the DnB Group.

[5] The 1999-profit was on pro forma basis for both DnB and Postbanken.

DnB Holding ASA is the total owner of Den norske Bank ASA, which again has a number of subsidiaries (figure 4). The most important operative companies owned by DnB ASA include: DnB Finans, DnB Factoring AS, DnB Kort AS, DnB Investor AS, and DnB Eiendomsmekling AS.

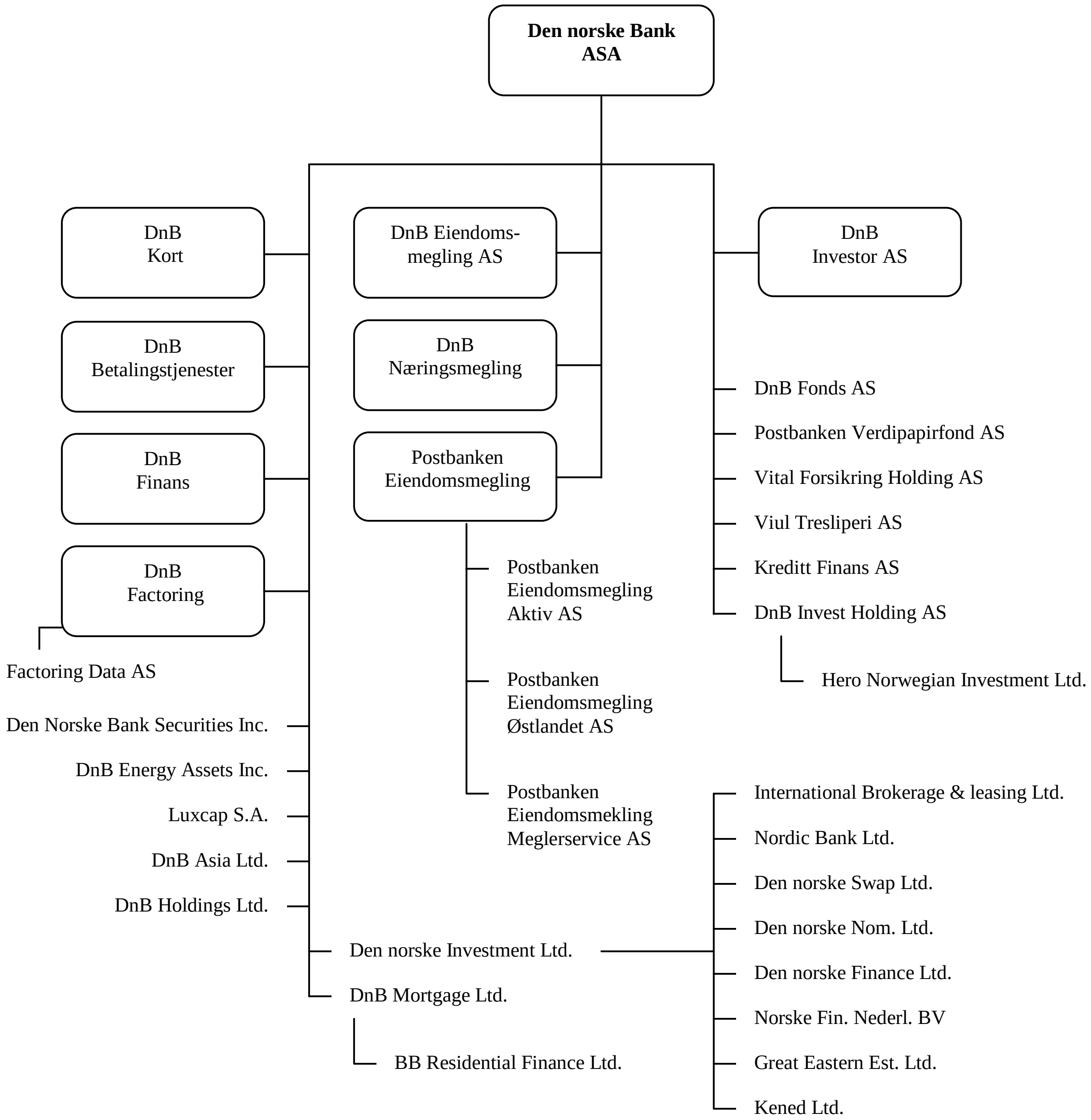

Figure 4: Subsidiaries of Den norske Bank ASA.

In May 2000, DnB reorganized its operations and certain responsibilities to achieve greater proximity to customers and further strengthen DnB e-banking operations. Changes included consolidating corporate market activities, including shipping clients, large corporate customers as well as small and medium-sized corporate customers, into one business area, while another business area is responsible for serving DnB's and Postbanken's private customers. In addition, a separate business area is now responsible for e-development.

The DnB Group's operations comprise six business areas, two of which serve various customer segments, while four are responsible for the development and marketing of specialized financial products across customer segments. Key customer segments are *retail customers*, including the smallest businesses, and *corporate customers*, serving small and medium-sized companies as well as large Norwegian corporations, shipping companies and international corporate customers. Specialized product areas are *capital markets* and *asset management.* The third and fourth product areas handle payment transfers and trade finance services together with other specialized products such as plastic cards, leasing and factoring services, as well as e-development.

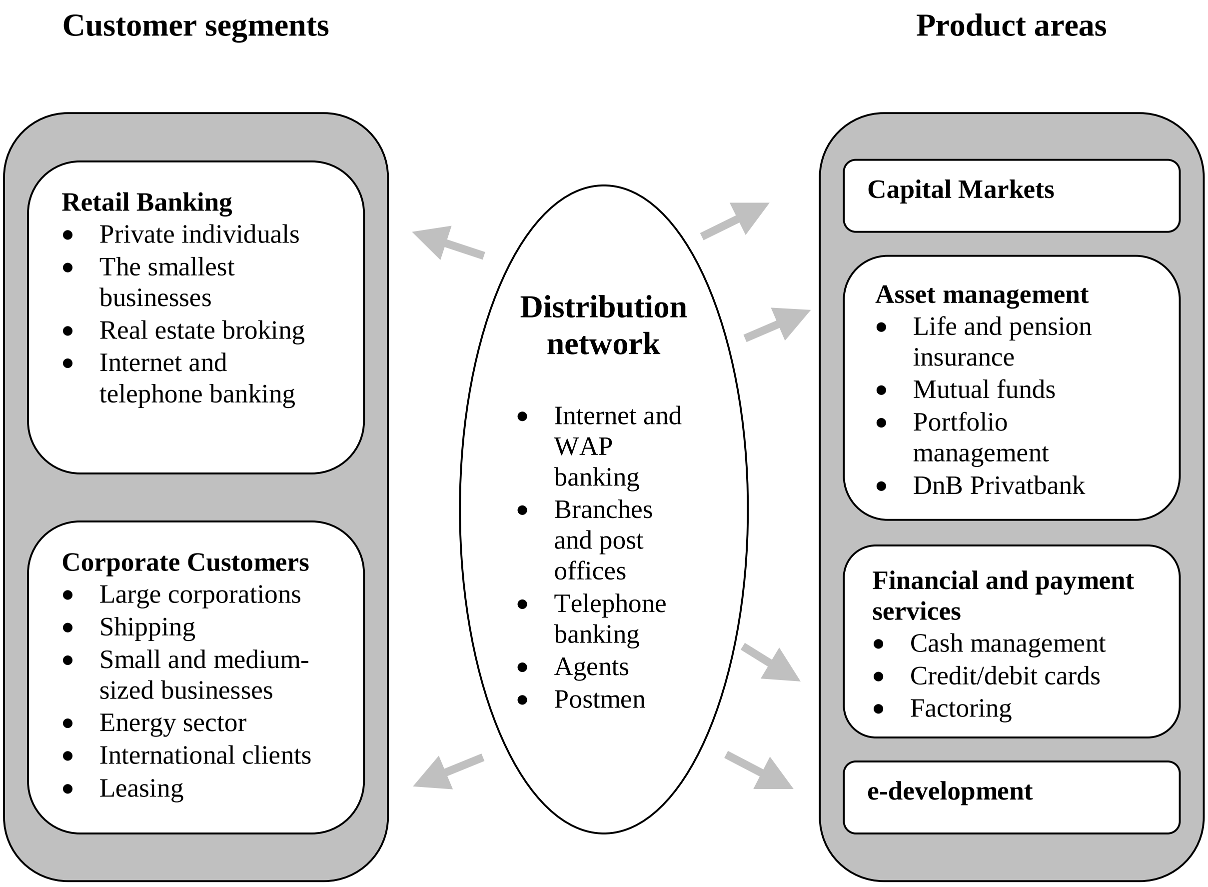

Figure 5: Customer segments – product areas.

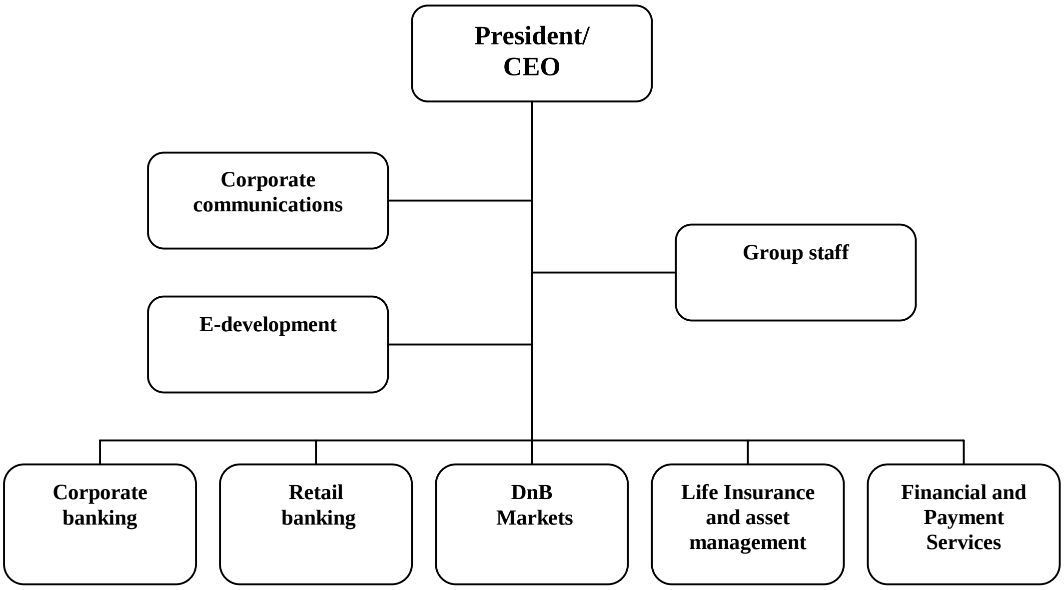

Figure 6: DnB Group – organization chart.

- Distribution network

The 1st of December 1999, DnB and Postbanken merged, and became the largest financial concern in Norway with a nation-wide distribution net. Den norske Bank ASA and Norway Post have a master agreement relating to the distribution of financial services through the postal network, which is effective until 31 of December, 2005. This agreement is an extension of the former agreement between Norway Post and Postbanken, and is based on transaction-specific prices and a joint aim to increase the number of financial services distributed through the postal network. Today, the concern's distribution channel consists of:

- 125 domestic DnB branches, of which 51 fully automated and 10 regional centers
- Six international branches
- Four international representative offices
- 19 Postbanken branches
- 19 Postbanken sales outlets
- Internet banking
- Electronic banking
- Telephone banking
- WAP banking
- Online equities trading
- 881 post office counters *
- 361 post office in-store outlets *
- 2400 rural postmen *
- 55 Postbanken Eiendomsmegling sales offices (franchises)
- 40 DnB Eiendomsmegling sales offices (all located in DnB branches)
- 20 Vital sales offices
- 29 Vital agent agreements

* Provided by Norwegian Post (the Norwegian postal system)

Further, the merging also resulted in a considerable increase in the number of customers that use the bank's Internet solution.

- *Strategic focus*

The DnB Group's strategy is to manage and further enhance the substantial customer base and distribution capacity in Norway. By offering the best financial products and services, DnB wants to be the preferred partner within the financial sector for Norwegian companies and households. DnB gives priority to meeting the specific needs of the various customers through a full range of competitive products.

DnB is dedicated to delivering shareholder value through the optimum use of its unique customer franchise. No other financial institution in Norway has a corresponding interface with its customers. In addition, the Group's Internet services, through Dnb.no and Postbanken.no, show fast growth. This unique customer franchise will be the focus of DnB's strategy by ensuring that the most value for the shareholders is extracted from the best distribution network and the best solutions at the lowest costs.

- *Strategic direction – gateway to the best products*

DnB is committed to providing its customers with access to the best financial products in the market. When those products are not available from within the DnB Group of companies, DnB will seek solutions from external suppliers. This could be of particular relevance for product areas where it is impossible to obtain critical mass in the Norwegian market. In such areas, DnB will therefore try to find international partners to secure competitive solutions for the most demanding customers.

DnB will create an operating environment based on appropriate management reporting systems, remuneration packages and ambitious financial targets, which will enable the Group to select and deliver the right products. DnB Group product areas will have to make sure that their products are not only able to compete with products from external suppliers in terms of performance and suitability, but also in terms of costs. This will create a competitive environment within the DnB Group, which is expected to deliver the best products at the lowest possible price.

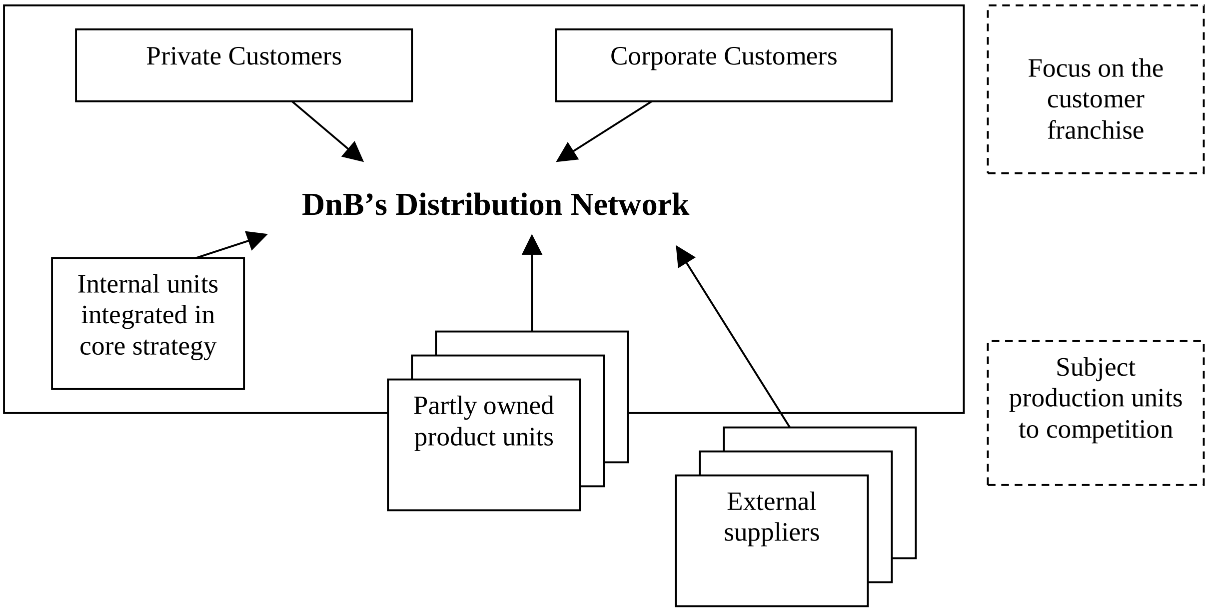

Figure 7: Strategy- Products: DnB will give the customers the best products, either from external suppliers or from units within the DnB Group. By doing this, the internal units will have to make sure that their products are able to compete with products from external suppliers in terms of performance, suitability, and costs.

- Strategic direction – gateway to Norway

By having a unique distribution system, DnB hopes that international companies that need financial products and services in Norway will choose DnB as their business partner. For the same reason, DnB also aims at being the most preferred institution for foreign financial companies when it comes to forming strategic alliances.

- Strategic direction – niche products

Norway has high personal computer, mobile phone and Internet penetration. Educational standards are above the European average. DnB will seek to maximize this combination to develop technology relating to financial services which could, in certain selected areas, be offered in markets outside Norway. Such areas could be Internet-based or require special professional skills, e.g. to support the development and operation of national payment services. Following the merger with Postbanken, DnB is Norway's largest payment services organization and expertise in this area could be attractive to countries in the process of developing their national payment systems. Additional expertise that could have an application in markets outside of Norway would include the shopping and offshore sectors.

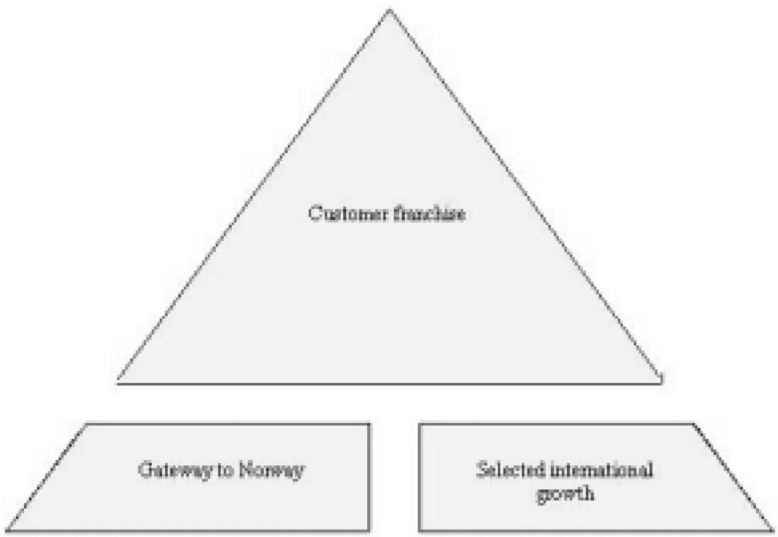

Figure 8:DnB Strategy: -Focus on the interface towards customers [customer franchise].
-Focus on providing international companies with a unique distribution system [gateway to Norway]
- Focus on specialized products that can be offered in foreign markets [selected international growth].

Markets and Structure

It is common to make a distinction between *active* and *passive* procurement of mutual funds[6]. The distinction between these to types refers to the roles that the agents possess. A passive agent does only provide the customer with information about the different financial products and suppliers, and the customer has to complete the transaction itself. In contrast, an active agent does carry through the transactions for the customer. To this point, we have not experienced any radical changes in the market for active funds procurement. Although the Internet is expected to have implications regarding actors' roles and the composition of the distribution channel of this procurement type, it is still large banks and insurance companies that play the dominant roles. However, in the market for passive funds procurement, new actors are taking a more visible position (e.g. Fondsnett.no), and the use of Internet as channel for transaction will probably lead to an exponential development of this procurement type. The reason for this assumption is that passive mutual fund procurement does not involve tight relations with the customers, thus the Internet is more suitable as a distribution channel for this procurement type.

[6] Typically, the roles of agents are organized in accordance with this dichotomy. In Norway, Acta [www.acta.no] may serve as an example of an agent that focuses on active procurement of mutual funds, while Fondsnett [www.fondsnett.no] is an example of a passive intermediary in the mutual funds distribution channel.

Another aspect that is likely to influence the future market structure in the mutual funds business is the modification of the statutory framework in the financial services industry. According to DnB, upcoming changes in legislation will lead to increased opportunities for implementing differentiation strategies on price. It will be possible to differentiate at the customer-level, rather than product-, and this will in turn make it easier for new actors to enter the funds market. DnB Investor will respond to this development by initiating brokerage boards for small and medium-sized enterprises.

As shown in figure 9, there are four upstream actors of high importance to Den norske Bank ASA[7]. These actors manage two different "types" of products; funds that are self-generated and funds that are bought from external product providers (third-part products).

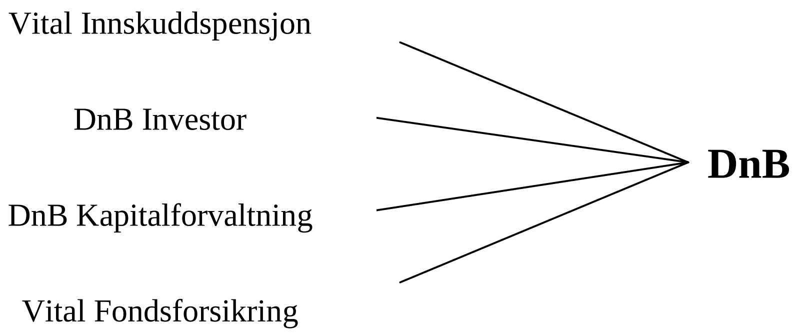

Figure 9: DnB's up-stream contacts regarding mutual funds products

DnB Investor AS is the DnB Group's mutual funds company and is required by law to manage assets in mutual funds separately. It is the second largest fund management company in Norway with a market share of 20,7 percent as at 31 December 2000. It has nearly 435 000 client relationships including 165 000 savings agreements (for clients making savings every month). Further, DnB Investor has approximately 5000 business customers.

DnB Investor AS manages funds under both the Postbanken and DnB brand names. The company's staff comprises around 80 full-time positions. Responsibilities include providing sales support and advisory services with respect to funds sold through Den norske Bank branches and the Postbanken network. Assets under management amounted to approximately NOK 29,5 billion at year-end 2000, a growth of 17 percent since 1999. Asset management fee income for DnB Investor in 2000 was NOK 465,4 million, compared with NOK 239,8 million for 1999, an increase of 94,1 percent. Management fees are calculated on

[7] Distribution of mutual funds from these providers is not dependent of DnB bank as an intermediary; these four actors provide direct sale to customers.

the funds on a continuing basis (fees range from 35 to 200 basis points depending on the type of fund). Sales commissions depend on the amount invested (up-front fees from 70 to 500 basis points depending on type of fund and client) and the amount accruing to the fund varies from 0 to 50 basis points. Commissions upon redemption are directly accrued to the various funds and vary from 0 to 100 basis points.

DnB Investor's product range represents internally managed funds as well as funds based on sub advisory accounts fund of fund with third parties. Thus, the company uses the strategy of buying products from sub-contractors and selling under their own name. In addition, The Norwegian Postal Service sells DnB Investor's products, and thereby constitutes a part of Investors customer interface. However, the Norwegian Postal Service delivers these products as part of their own assortment.

DnB Investor manages a set of different portfolios, focusing on geographic areas as well as sector specific portfolios. It offers 13 money-market and fixed-income funds and 31 domestic and international equity and balanced funds, four of which focus on specific sectors (consumer goods, finance, health care and technology). DnB Investor cooperates with about 50 brokerage houses, but operate only in an advisory position towards customers.

DnB Kapitalforvaltning ASA is one of the leading discretionary asset managers in Norway. At year-end 2000, the company managed NOK 67,8 billion on behalf of clients, up from NOK 65,0 billion in 1999. DnB Kapitalforvaltning carries out discretionary asset management (NOK 9,5 billion) on behalf of private individuals (11 percent), corporates (14 percent), pension funds (61 percent), the public sector (6 percent), and trusts (8 percent).

Asset management incorporates the management of individually designed investment portfolios by DnB Kapitalforvaltning. Assets include global equities, bonds and derivates as well as mutual funds managed on a discretionary basis with reference to relevant indices. An important part of the service is to advice clients with respect to strategic allocation, risk levels, specific mandates and on-going monitoring of portfolios. Thus, DnB kapitalforvaltning's role is to administer mandates from their customer; they make buying decisions on behalf of customers, but only within the frames of that specific mandate. DnB Kapitalforvaltning has approximately 180–190 customers, and it is a requirement that these customers make an investment of minimum NOK 5 million. Business customers constitutes 60-70% of the total customer mass.

Vital Fondsforsikring is a subsidiary of Vital Forsikring ASA, Norway's second largest private life and pension insurance company. It is responsible for developing and offering unit linked products, and has approximately 2000 customer relations. These products are not directed towards the business market. However, products tailored to DnB's corporate customers enable Vital to benefit from the large potential in DnB's corporate customer base, which includes many companies without corporate pension plans.

Vital Innskuddspensjon is a newly initialized company that offers savings services by mutual funds investment. This company directs all attention towards the business market, and aims at capturing 100-200 customers within a 4-year period.

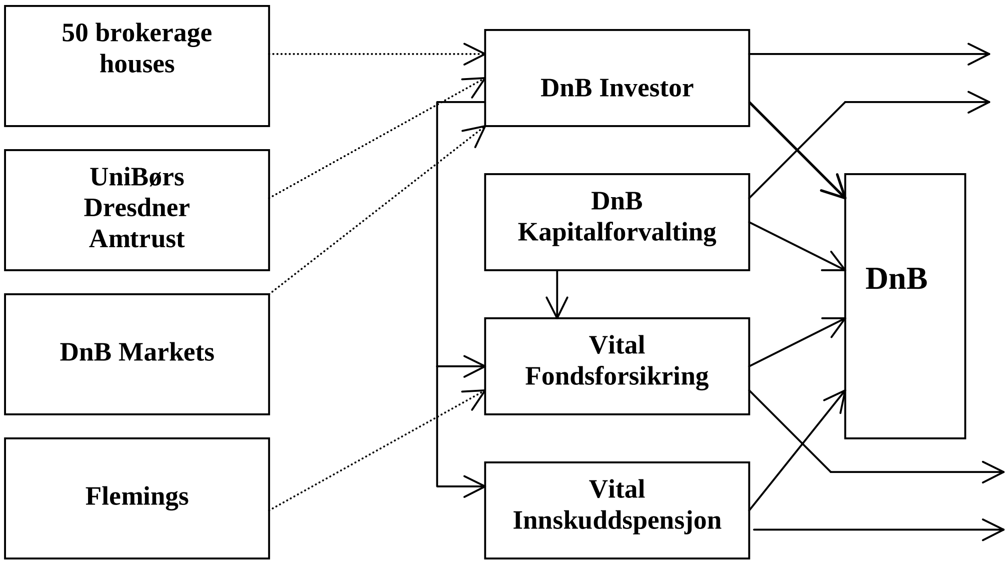

Figure 10: Mutual funds product providers relevant to the DnB Group.

There are mainly four different mediating channels operating between DnB and their end customers (figure 11); “brokerage boards”, assurance companies, independent agents and dependent agents. In addition, there is a specific unit within Den norske Bank ASA that focuses solely on concern/enterprise customers.

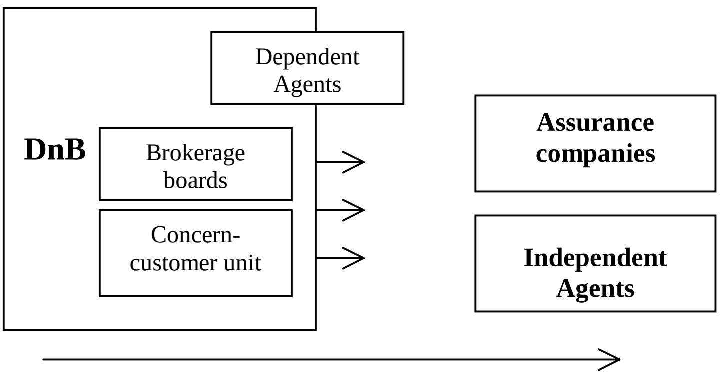

Fig. 11: Mediators between DnB and the end customers.

There are 9 *brokerage boards* in Norway, which attend to their customers' interests. These "units" are an integrated part of DnB's organization, and are composed of representatives from the different subcontractors to DnB. In contrast, both *assurance companies* and *independent agents* operate independently of DnB, and use DnB's products only as a part of their assortment. That is, these mediators also buy products from other product providers. The *dependent agents*, however, are closer related to DnB than independent agents and assurance companies.

In contrast with the brokerage boards' focus on commissions, the internal unit that is engaged with enterprise customers is to a lesser extent commission-oriented. DnB has approximately 100 – 150 enterprise customers, primarily consisting of large Norwegian corporations, international customers within oil and energy, public sector and financial institutions. The strategic focus within this unit is continued emphasis on cross selling, particularly with regard to corporate finance and asset management, maintenance of satisfactory credit portfolio quality and continued reduction of international and non-strategic exposure, and making the service concept available on the Internet by providing value-enhancing services for clients.

DnB Investor accomplishes approximately 80-90% of the total mutual funds sale of the DnB Group (business customers). As mentioned earlier, the brokerage boards in DnB are composed of representatives from various subcontractors, and are dependent on the product in question. As a consequence of different compositions of brokerage boards relative to various products, DnB Bank's role in mutual funds distribution is dependent on the product type being sold. In any case, each business customer relate to only one person from this board as their contact. This reflects DnB's focus on customers rather than product, where a lot of effort is invested in building one-to-one customer relations.

There is an obvious disparity in the importance of different sales channels for these four main product suppliers. In the case of *DnB Investor*, 75-80 per cent of the transactions are handled through brokerage boards, while agents handle the remaining 20-25 per cent. DnB Investor has grown from offering 25 different mutual fund products to 42 in just one year. However, the assortment volume has to increase in order to be competitive, and DnB Investor believe that a sufficient increase in the product range can only be accomplished by engaging in relationships with other product providers. In other words, they will try to increase their market shares by using the competence of external and specialized suppliers.

DnB Kapitalforvaltning outsource all customer contact to brokerage boards, while approximately 75 per cent of *Vital Fondsforsikring*'s distribution of mutual funds are mediated by independent agents and 25 per cent are sold through dependent agents. *Vital Innskuddspensjon* will use both dependent and independent agents, and the company anticipates that their products will compete in a market worth about NOK 10 billion within a three years period.

Technology

The DnB Group Internet bank was introduced in April 1998, and by the end of October 2000, 232 546 Internet banking clients have signed up. Trading in mutual funds started in June 1999. Equities trading commenced in October 1999 at Dnb.no/aksje, offering a complete trading system for Norwegian shares and primary capital certificates. The clients may choose between payable real-time or free, 15 minutes delayed information on Norwegian stock prices, main market indices and updated stock market news. The system also provides direct access to the clients' gains or losses on the shares in their account. Approximately 25 per cent of DnB Markets' total number of transactions is made online, representing approximately 6-7 percent of the total volume. About 10 000 clients had signed up as at 30 September 2000, and the average transaction value is approximately NOK 51 000 per client.

DnB was the first bank in Norway, and among the first in the world, to introduce WAP banking (November 1999). This service is available to DnB retail customers and Postbanken's customers, and includes access to account statements as well as payment services. The service is accessible through ordinary GSM phones as SMS messages or through WAP phones.

Communication with customers is to a certain extent done through their web sites. Customers are able to monitor their share holdings, and they are also offered an advisory calculator; a tool which makes it possible to see how different investment options influence interest, and thereby predicting future profit.

The marketing of DnB's four product providers (DnB Investor, DnB Kapitalforvaltning, Vital Fondsforsikring, and Vital Innskuddspensjon) is done through brokerage boards, using direct dialog with customers. Communication between brokerage boards and their customers is to a certain extent carried out by e-mail. However, there is no strategy behind this use.

The development of Internet as a strategic tool for marketing- and communication is differently emphasized throughout the DnB Group. The rate of traffic on DnB's web sites is high, but there is no functionality that supports mutual funds transactions. Their web pages are only used as a channel of information, while the transactions are carried out in traditional ways. One of DnB's main objectives is to increase their customers' competence of mutual fund products, and as a consequence, DnB's marketing efforts is to a large extent focused on already established customer relations, thus resulting in a quite static and non-growing customer mass. Another problem is that mutual funds (from the four product providers) can be purchased through channels that are external to DnB, while the opposite is not possible. That is, the DnB customers don't have the opportunity to buy none-DnB products through a DnB sales interface. When transactions are carried out, DnB debit customer-accounts. However, there is no direct link to the customers' underlying accounting systems, thus the customers have to balance these systems on their own.

DnB Investor on the other hand, has a considerable more aggressive strategy in this area. This has lead to an increasing bypass of DnB as an intermediary in the distribution channel. Thus, DnB is forced to compete on equal terms with other intermediaries, creating an internal market situation.

Customers are informed of developments and trends in the mutual funds market through morning reports, issued by DnB centrally. These are based daily analysis, and are delivered via an e-mail service. In addition, monthly reports are also available. However, as opposed to the morning reports, the monthly reports are sent directly from DnB Investor by use of e-mail or traditional mailing services.

Vital Fondsforsikring (and to a certain extent Vital Innskuddspensjon) are dealing with products that are more applicable to Internet distribution than many other financial products. Further, their customers are above average regarding knowledge of the involved products, and it is easier and potentially more successful to conduct training and educational schemes with these customer groups. Thus, Vital Fondsforsikring and Vital Innskuddspensjon perceive web-based transactions as a distribution form for the future. Their web-solutions will be launched quite soon.

DnB has appreciated establishing an advisory/consultative full service Internet portal service (equivalent to Fondsnett.no), which where supposed to offer all kinds of funds products. However, DnB believe that there is only room for one such service in the Norwegian funds market. Fondsnett was at the time, and still are, well established in this market, and DnB where not willing to expose their products to this competition.

DnB’s investment cost for information technology infrastructure amounted to NOK 271 million in 2000.

Electronic commerce initiatives

- *Netaxept*

On 30 June 2000, DnB established a 50/50 joint venture with Norway Post. The new company, which is called Netaxept, will provide a secure payment system combined with a delivery system for goods purchased online. The company plans to launch a pilot project together with an Internet shop.

- *Doorstep*

In July 2000, DnB established a 50/50 joint venture with Telenor (the leading Norwegian telecommunications company). The new company aims to be the leading Internet shopping portal in Norway. In the first release the company will focus on distribution of online and mobile financial services. Some telecommunications and existing m-commerce services will also be distributed through the portal.

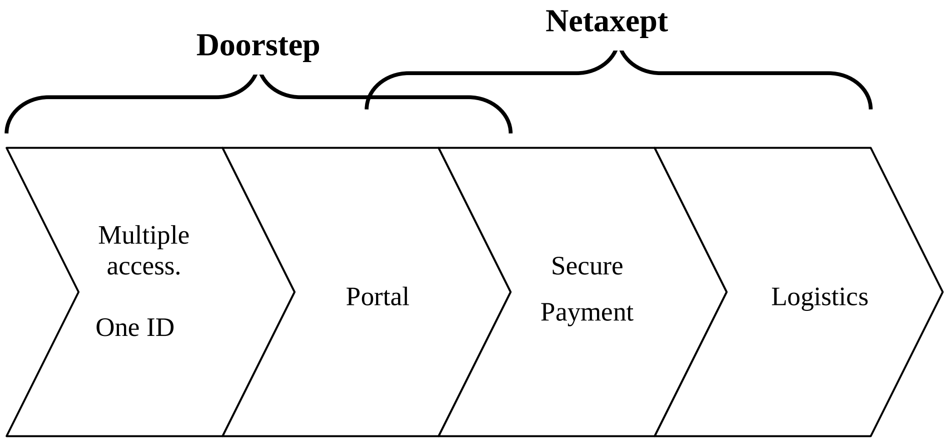

Figure 12: Value chain and e-convergence[8]

- Joint venture with Accenture, Norway Post SDS and Telenor

On 30 October 2000 DnB, Andersen Consulting (now Accenture), Norway Post SDS and Telenor announced the signing of a letter of intent for a new joint venture, which aims to become the leading operator for electronic commerce to the Norwegian and Scandinavian corporate markets [B2B]. The joint venture will establish an electronic marketplace for the public sector.

- Teleinsurance

Through Teleinsurance, Vital has opened up for interactive communication with insurance customers via the Internet. The service gives corporate customers (and their staff to come) updated information on their pension schemes and is used by a total of 320 companies with nearly 50 000 employees. Vital will also launch an Internet-based pension advisory service in 2001. The service will be interactive and offer customers advice on pension savings based on the customer's preferred savings and pension profile.

[8] Doorstep will be the entrance to what will become a new virtual "city" with its own secure shopping facilities, bank, and a post office. At Doorstep, all purchases will be paid for at the same check out point, which increases the safety as well as it is convenient and practical. Further, it will be a multi-channel shopping center, where the "shopping mall" can be accessed via PCs, mobile phones through SMS, PDA through UMTS, or a mobile WAP telephone. This online shop requires secure and flexible payment and delivery systems, and this is provided for by Netaxept, which will be an integrator for settlement and deliveries.

- Telefactor

Telefactor is a web-based information system enabling DnB Factoring[9] clients to access all relevant information relating to their status of their factored receivables. The system provides information on both a portfolio basis and a more detailed level. The product was introduced in the summer of 1999 and by the end of September 2000 more than 70 percent of DnB Factoring's customers are regular users of the system.

Interview Response

-Motivation

The DnB Group appreciates the strategic opportunities and competitive advantages that are related to the use of Internet as a sales- and marketing channel. Through brokerage boards, DnB is already today focusing on one-to-one marketing. Operating in the mutual funds market, where the complexity of products and services is extensive, one-on-one advisory- and communicational skills becomes more and more important. DnB sees the Internet and customized web-applications as the future in taking their strategy of direct marketing a step further.

In many countries, *Index Management* has become a popular way of investing in mutual funds. The way Index Management works, is that funds managers seek to minimize the divergence between their investment products and the public day-to-day funds index. The complexity of this product is much lower, thus easier for the customers to manage by them selves. As a consequence, the advisory element that DnB focuses on will to a large degree vanish as a strategic advantage. New and less complex products will, according to DnB, increase the rates of transactions over the Internet; enabling customers to manage their own investments.

Vital Innskuddspensjon and Vital Fondsforsikring see customers' opportunities for replacing or changing their funds investments online as a more important feature than first-time buying. Due to the very low costs of using the Internet to manage such replacements, it could also lead to an increased transaction rate.

The price setting mechanisms make it possible for Internet to become an important strategic tool regarding mutual funds exchange services. Today, prices of different funds are set once a day. If this price setting process is executed more frequently, the whole process of buying funds could change. In addition, the Internet will become a more dominant factor when mutual funds suppliers get larger margins in their pricing strategies. That is, a more differentiated price scale is likely to result in increasing importance of the Internet as part of a distribution channel. The brokerage boards are to a certain degree trying to achieve customer segmentation. The Internet has the ability to support such differentiation-, customization- and

[9] DnB Factoring, a subsidiary of Den norske Bank ASA, is the second largest provider of factoring services to the corporate market in Norway with gross a lending and receivables of NOK 457 million and a share of factoring turnover in Norway of around 23 percent in 1999. DnB Factoring also focuses on providing cross-border factoring services and offers Norwegian exporters risk hedging and local collection of receivables through correspondents in most industrialized countries.

segmentation strategies in a very efficient way. Still, the brokerage boards' follow-up strategies vary from customer to customer, and will not be affected by the Internet as a communication tool. Further, DnB also believes that different bundling strategies will not be affected by increasing use of online services. Each product composition is unique, and according to DnB, the Internet does not make this bundling process any easier or more efficient.

DnB does not believe that Internet will give any additional value to mutual fund products. In other words, they don't see this technology as a tool for creating competitive advantage, but rather as a necessity for being able to compete on equal terms as other financial services providers. Hence, if DnB doesn't invest in development of Internet technologies and make it possible for customers to carry out online transactions, it may represent a competitive disadvantage.

As for the dynamics of value chain environment, the Internet gives rise and support to any actors that are willing to enter the mutual funds market. If a strong actor representing the supply side enters into the market (like Fondsnett), DnB believes this will lead to a decrease in loyalty towards suppliers. This could in turn result in a possibility for new actors to gain foothold in the mutual funds market.

- *Obstacles and advantages*

Regulating factors

Better user interfaces, which reduce customer-made mistakes, are perceived as an important factor for reducing costs related to use of information technologies. Another aspect of such technological features is network reliability. Today, the brokerage houses have the economic responsibility for any failed or unsuccessful transactions. However, when customers carry through these transactions on their own, they will also have to accept any economic responsibility if transactions are failing or turn out to be unsuccessful. On this basis, the threshold for conducting online transactions may increase. Thus, if network stability and reliability are inadequate, the customers will not make use of the technological opportunities provided by the financial institutions, and investments in technological solutions that are made could be lost.

Internal factors

When DnB started to focus on web-applications and Internet technology, the company wanted to develop its strategy and technological solutions in-house. As a consequence, the progress has been slow, and DnB are one or two steps behind the leading actors in this area. However, because of a very positive attitude regarding development of innovative Internet strategies among their company executives, DnB feel that it is possible to can catch up with the market leaders on web-based funds transactions.

Strategic factors

Those actors that start offering index management will be able to reduce their sales-costs because of less complex and highly standardized products. Such products give customers a better view of the available alternatives, thus making lock-in mechanisms less effective strategic tools. Well-developed advisory services could make up for this loss of strategic options, and lead to more loyal customers.

Public factors

There are many obstacles associated with various intermediary roles in the mutual funds distribution channel (e.g. Fondsnett). A modification of legislation is in progress, which will remove most of the entry barriers that limit newcomers' possibilities in getting foothold in the mutual funds market today. Other changes will also be carried out within the relevant legal framework: Changes that are made render possible products like "Innskuddspensjon"; a product that, in order to be successful, has to be supported by Internet technology. There will also be changes within the legal frameworks that regulate how price setting is carried out. This will make it easier to differentiate on price, and can then be done at customer-level, in contrast to today's product differentiation. According to DnB Investor, such changes will also make it easier to offer "funds-in-fund" products.

In order to restrain whitewashing of money, starting up as a customer in the funds market means fulfilling requirements in the law, which is very strict in Norway (i.e. new customers have to legitimate themselves). By adjusting conditions for the application of "digital signatures", these requirements of the law can be eased up.