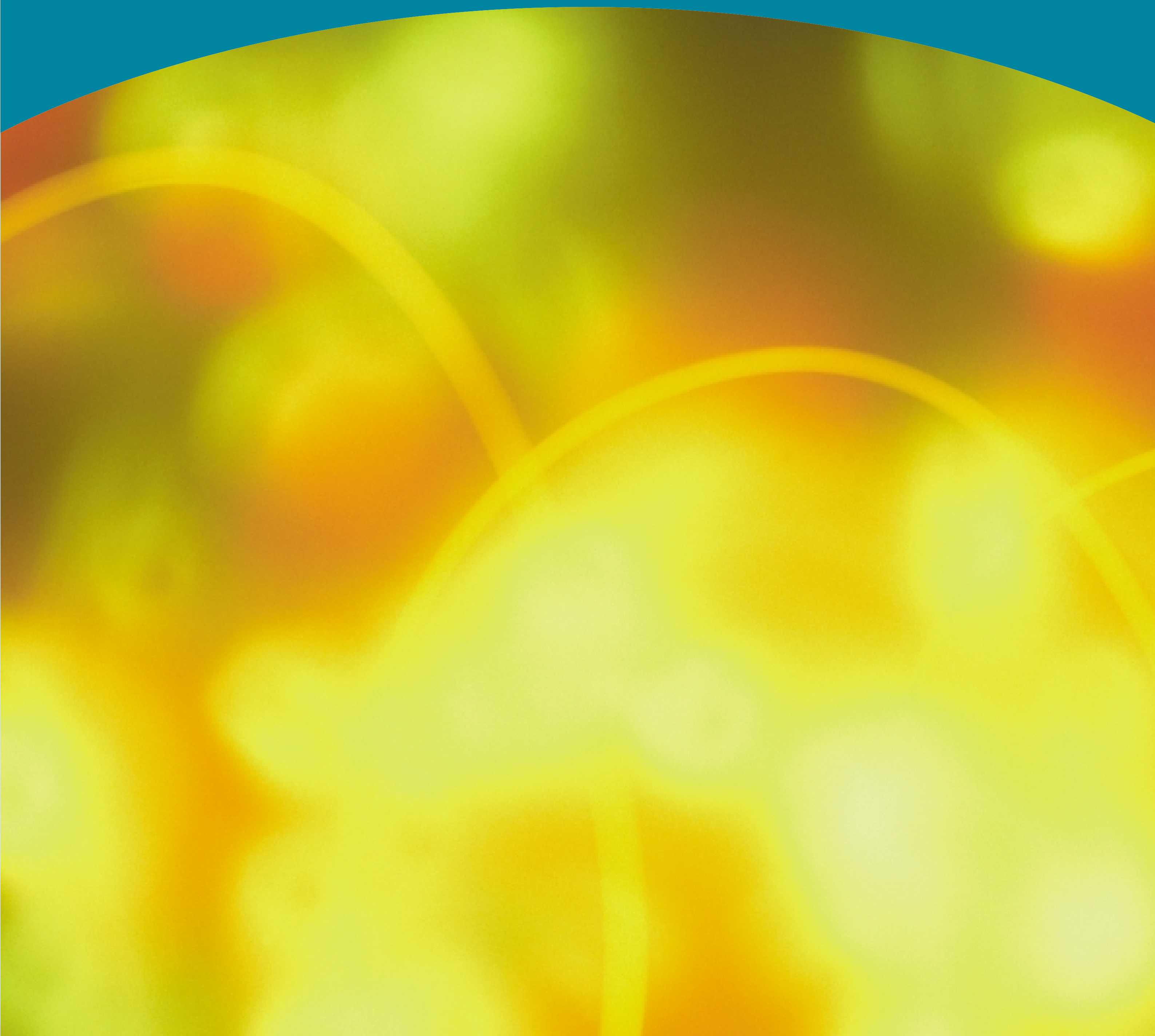
Employers Skill Survey:
Case Study
Banking, Finance and
Insurance Sector



EMPLOYERS SKILL SURVEY

Case Study - Banking, Finance and Insurance Sector

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FOREWORD

The Secretary of State for Education and Employment established the Skills Task Force to assist him in developing a National Skills Agenda. An important part of this remit was to provide evidence on the nature, extent and pattern of skill needs and shortages and their likely future development. The research evidence assembled by the Task Force was summarised in "Skills for all: Research Report from the National Skills Task Force", published in June 2000.

An important contribution to the evidence was made by a major programme of new research. This included two employer surveys, detailed case studies in seven different industries and a review of existing surveys. We are grateful to all those who participated in this research and so contributed to the work of the task force. This report provides more detailed information on one element of this research. Details of associated reports are listed in the rear of this publication.

It should be noted that the views expressed, and any recommendations made, within this report are those of the individual authors only. Publication does not necessarily mean that either the Skills Task Force or DfEE endorse the views expressed.

Contents

EXECUTIVE SUMMARY

This report provides a detailed assessment of skill needs and the extent and impact of skill deficiencies within Banking, Finance and Insurance.

SIC92 Groups 65, 66 and 67 encompass banking, finance and insurance activities. These range from banking and other financial intermediation, life and general insurance, pension funding, to the Lloyd's market. It is an industry that has been undergoing dramatic change over the last decade, with both structural change and technological advances having had significant influence on the provision of banking and financial services. Industry changes have resulted in pressures on top management to rethink their business strategies, and for management, overall, to drive successfully the implementation of new strategies.

Not surprisingly, firms have skill problems. The changing nature of banking, where banks are moving from on-balance to off-balance sheet activities, together with an increasing involvement in capital markets, have created a need for skills that are quite different from those of traditional lending. Traditional players, with 'legacy' skill-sets which do not match current needs, have been addressing this problem throughout the 1990s. At the same time, intensifying competition, especially from new entrants unencumbered with traditional branch networks, means that strong management skills have become a requirement in UK banks, particularly as these have only recently become viewed as businesses themselves.

The Lloyd's crisis in the early 1990s showed the importance (and deficiency) of strong management skills among the different parties in the market. Pressures in the London Insurance Market have resulted in the decline of some skill-sets (Names Agents'), the emergence of new skill-sets (corporate financial advisers for this market), and a reconfiguration of skills (between brokers and underwriters).

Current skill problems are compounded by moves into Internet activities (banking, general insurance, stock market trading, and payment systems), which require new skills and a reconfiguration of skills between client/customer and financial institution. Business-to-business activities are already prevalent and expected to grow. There is uncertainty about retail customers' preferred channel(s) - PC and Internet, interactive digital television, and web-based mobile phones are all technologies in the ascendant. It is anticipated that more business will be undertaken by such means, rather than through the branch network, But there is uncertainty about the extent and pattern of uptake and, therefore, the skill mix required.

Factors which characterise banking, finance and insurance are thus the polarisation of skills (linked to whether technology automates or 'informates'); transitional skill-gaps occurring across all sub-sectors; and the need for traditional firms to transform their operations sufficiently quickly to match market changes.

Product-market strategies

The eleven cases undertook a range of financial functions (payment services, savings products, fiduciary services, lending, insurance and risk management). These functions, singly or in combination, were provided by two investment banks, an outsider with a financial services department, two high street banks, a mutual building society, and composites of Lloyd's brokers, insurers, Names' Agents and parts of the Corporation of Lloyds. In the wholesale/investment sub-sector, two cases operated within global markets and the third was moving into the continental European market. In the retail sub-sector, the banks operated nationally, while the building society had a mainly regional market.

The principal drivers for change - ICT developments and applications; deregulation and re-regulation; intensified competition; and world-wide economic growth - result in firms emphasising:

- Provision of innovative solutions and advice
- Customer/client convenience
- Quality of service
- Differential pricing
- Product design to support changing lifestyles
- Brand and customer values
- Speed
- Customer relationship management
- Building alliances and partnerships
- Information provision and capture

Many low value-added transactions have been automated, while higher value-added activities (such as providing financial advice or developing new, sophisticated financial products) require intermediate or professional level skills. Traditional banking skills no longer have the level of importance they once had, with the move to a broader product range. In the retail services sub-sector, the drive towards more profitable activities has extended the range of skills required in selling more specialist services such as savings and investment products. Because of the need for informed advice and a history of mis-selling, the FSA now requires financial advisers to hold recognised qualifications.

In summary, the effect of competitive pressures and product-market strategies is that for wholesale/investment banking:

- Top management need skills to identify firms with whom they can develop alliances, partnerships, mergers and friendly take-overs and manage the relationship or integration successfully.
- High level technical skills are increasingly needed for developing financially efficient products.
- Team skills or hybrid skills are needed in the growing market for providing advice, where the advisor-client role is moving away from 'expert/ telling' towards 'consulting/ partnering'.
- Investment activities and knowledge are increasing in importance.

- Risk management skills to support overall business activities are vital at the corporate level.
- Information technology skills of the highest calibre are required to develop ever more intricate systems that (i) support banking and finance activities at the global level, and (ii) deliver efficiencies and cost savings.

For retail banking, finance and insurance:

- Firms need data entry and clerical skills in processing and other back-office functions, which have not yet been fully automated.
- Sales skills are needed in branches, as staff are expected to engage in cross-sell while, also, successfully managing the client relationship.
- Call centre staff need telephony skills currently, but as more firms move to multi-channel centres, broader skill-sets will be needed.
- Product development skills are essential since sales are influenced by the quality of the products/services.
- Strategic marketing skills are important because of the need to develop brand image especially with the move towards Internet business.
- Specialist information technology skills and hybrid technical/business skills are of critical importance since technology underpins many key operations, products and services.
- Change management skills are critical in established firms that are seeking to become more flexible and responsive, and there is a need for significant staff attitude change.

A number of criteria, suggested by Deloitte Consulting (1999) were used to make an assessment of the sustainability of firms' product/service strategies. Based on this, two companies appeared to be in a strong position in high growth markets in some of their major business for the foreseeable future, one seemed to be successfully establishing its position in a newly growing market, two were holding strong positions in relatively mature markets, and one was in a weak position.

Production processes

Dramatic growth in the volume and size of financial transactions, proliferation of products from deregulation, globalisation of product/services, and other product-market developments have been made possible by increasingly sophisticated information and communication technology (ICT). As a mass-processing tool, computers allow for significant increases in output per employee, and ICT allows for the centralisation of processing in low cost locations. In addition to reducing costs, ICT helps improve quality through the provision of real-time operations, constant updating of customer information, reduced delays, increased reliability of outputs, and standardisation of decision making. Business process re-engineering has been a significant initiative in firms seeking to improve customer satisfaction, reduce cycle time, and deliver 'total quality'. Technology also underpins new delivery channels and services.

Technology and increasing competition have driven change within organisations, with a reduction in management layers, increased contact between staff and customers, devolvement to employees of responsibility for meeting quality standards, increased clarity in roles and accountability; and encouragement for self-development.

Technology and changes in methods and organisation also result in a need for new skills. Operating in a performance-driven culture and a climate of uncertainty requires a broader range of skills than simply technical skills. These include team-working, flexibility, communication skills, and problem solving. The industry is thus similar to others where jobs have broadened and more is now expected of staff.

Skill Needs, Recruitment and Skill Deficiencies

Banking firms were easily able to identify their critical skill needs. However, because of the fast-changing nature of competition and technology, firms were unable to produce detailed business strategies much beyond 2-3 years. In all cases, when management was formulating its business strategy, skill implications were a secondary consideration, and skills were merely one of several resources brought into the equation. The nature of these skills, however, is well-known in banking. In the wholesale/investment banking sub-sector, the main problem is predicting volume and timing, as markets experience sudden volatility. In the retail service sub-sector, the main problem is predicting volume and timing because of uncertainty about uptake of technology and consequent strategies for delivery capacity adjustments.

The report details skill needs identified by banking participants in terms of (i) specialist technical skills and (ii) hybrid specialist skills in the wholesale/investment and the retail services sub-sectors. Specialist and other skill needs were identified for different entities operating in the London Insurance market, where firms tended to equate ‘skills’ with ‘technical’ skills, rather than adopting a broader interpretation.

Since demand for products and services is largely a function of economic activity, where this changes, so too does the profile of the business. The continuing strong performance of the US and UK economies means that demand for products/services is in general currently high. In the banking cases, recruitment was linked to business growth although, in call centres, recruitment was also linked with high staff turnover. Skill shortages were found in specific areas, such as complex sales and trading functions, asset management, and investment advice for certain industries such as media and telecommunications. These shortages arise when there are relatively few people with these skills in the market, and this coincides with ‘hot’ markets of peak activity. Skills can prove problematic to recruit when, for example, firms are unwilling to train and are seeking large numbers from the market (such as regulated sales staff), or when firms are not located in financial clusters and people are reluctant to move outside the job market in London or the other large financial centres.

Companies have developed a range of solutions to deal with recruitment difficulties, the most important of which are:

- Improving school/university links
- Taking advantage of other firms downsizing
- Using contractor and temporary staff
- Outsourcing
- Relocating
- Changing person specifications
- Increasing the search area

Larger firms tended to have formal systems for recruitment supported by HR specialists. In the wholesale/investment banking sub-sector and in the London Insurance market, managers sought candidates (and teams) for selection on their track record and likely ability to fit the existing team/structure. They differed, though, in their valuation and requirement for qualifications. Because some firms in the industry have failed to establish systematic recruitment systems, the FSA is insisting that firms falling under their regulation will be required to make improvements (FSA, 1999).

There is a general broadening of skills and improvement in the skills-base. In wholesale/investment banking, the overall trend is towards rising skill levels, but in retail banking and financial services, there is a mixture of reconfiguring skills, rising skill levels, skill obsolescence, and cultural change.

As a result, because of technological and competitive change, skill gaps are prevalent. Strategies to address skill gaps take three forms - upgrading skills, organisational solutions, and strategic responses. ‘Strategic responses’ are a way of circumventing the problem, rather than dealing with it directly. Sometimes this is a form of avoidance and pushing responsibility elsewhere; in other cases, it involves specialisation within the market.

Skill gaps are thus found within all the case companies, as staff absorb changes wrought during the implementation of business strategies, and develop new skills and attitudes required. Training to facilitate this process is provided, but there is a move towards increased facilitation of learning ‘on-the-job’ through coaching and intranet usage, rather than sending people on training courses. Strong management skills are needed to ensure coaching takes place because, with the removal of management layers and consequent organisational flattening, spans of control have widened.

Skill Deficiencies: An assessment

The study indicates that a majority of the case companies in the banking and finance sub-sectors have a clear understanding of what is required to compete successfully. Their detailing of critical financial functions and changes in skill needs for delivering business strategies in these areas suggests an appropriate level of awareness of skill requirements. Companies also recognise skill gaps and are taking substantial measures to address them. Recruitment difficulties, where they exist, tend to be due to currently high levels of activity driven by positive economic conditions. In both the banking and finance sub-sectors and the London Insurance market, a large pool of skills has been created through restructuring by mergers and acquisitions or downsizing. Firms are drawing on this.

The picture of a keen awareness of skill needs in the banking and finance sub-sectors is substantially different to that found in the London Insurance market, where the recognition of skill sets and the acceptance of the value of skills is a fairly new phenomenon. Although not yet sophisticated in either, steady progress is being made, driven by the Corporation and an improved regulatory environment.

Evidence of unrecognised skill deficiencies and performance difficulties (where they exist), resulting from skill problems or unsuitable skill strategies, is reported for each case. In the retail banking and finance sub-sector, performance is keenly influenced by the quality of the technology supporting the product/service offering. If this is inadequate it may be due to a skills deficiency, on the part of senior management, in failing to recognise or invest in the necessary technology, in which case, this may be interpreted as a latent skill deficiency. In such a case, if this were remedied, it would have impacts on skill requirements in various other jobs.

In the retail banking and finance sub-sectors, it is likely that continuing technological developments will lead to future skill deficiencies, as volume and timing of skill needs will only become apparent when delivery capacity requirements become clear. The implications are that companies (and individuals) will need to identify this early, and respond quickly and flexibly. Strategic skills to gain and analyse information will be important. HR processes can support business development, but need regular evaluation to ensure their relevance to strategy implementation. Strong management skills can also help drive implementation, and companies who develop change management capabilities will hold an advantage.

Generally, however, the study supports the findings of Hasluck (1999). Companies in the banking and finance sub-sectors provided little evidence of significant skill gaps. Rather, they often resulted from other (external) factors, in the form of recruitment difficulties.

Within the London Insurance market, however, there is a significant latent skill deficiency in two areas. The first is a failure to perceive that e-based trading will demand new skill-sets, or new mixes of existing skills. The second lies in the field of knowledge management where, as the market moves to electronic trading, informal knowledge development and dissemination between brokers and underwriters will disappear, with nothing to replace it as yet.

Looking to the future in the wholesale/investment banking sub-sector, latent skill deficiencies might arise in two areas. In global processing, cost is the critical factor. Given the huge volume of work, a very small reduction per item processed can result in a major saving or change in competitiveness. The options for cost reduction are relocation to a lower labour cost area (with the UK seen as a high cost area), or further automation. The latter solution requires a very high level of IT skills, which, however, are thought to be in short supply. A second area is in mainstream investment banking. Moving up the value chain involves moving into more labour-intensive relationship areas, where the expertise, quality and experience of staff is very important. These are areas where there is intense competition in the London market for staff.

PART A: INTRODUCTION

1. AIMS AND CONTEXT

1.1 Aims of the Study

The aim of the research on which this report is based is "to provide a detailed assessment of skill needs and the extent and impact of skill deficiencies in key sectors of the British economy."

Underpinning this is Finegold and Solkice's notion of the 'low skills/low quality equilibrium' which they introduced, more than ten years ago, into the debate about the role of skills and knowledge in organisational performance and national competitiveness. They proposed that the absence of a well-educated and trained workforce has meant that UK industries have been unable to respond to changing economic conditions:

The best way to visualise this argument is to see Britain trapped in a low-skills equilibrium, in which the majority of enterprises staffed by poorly trained managers and workers produce low quality goods and services. The term 'equilibrium' is used to connote a self-reinforcing network of societal and state institutions which interact to stifle demand for improvements in skill levels.
Fingold and Soskice (1989:22)

A key hypothesis derived from this is that 'better performing firms will have identified sustainable product strategies, and developed effective skill strategies for resourcing these'. This report, therefore, describes the findings of a case study investigation of skill issues within banking, finance and insurance. It identifies the product-market strategies of the case firms, the skill implications of these strategies, and how skill needs are being met. From this, a judgement is made on whether there is a skill deficiency in these organisations and the impact on organisational performance.

1.2 Characteristics of the Sector

Banking, finance and insurance include a wide group of activities, the principal of which are indicated in Table 1. The sector undertakes monetary and other financial intermediation, insurance and pension funding, and auxiliary activities, such as security broking and fund management. Many of the activities of the sector are subject to regulation by the Financial Services Authority (FSA).

Table 1: Banking, Finance and Insurance Activities

Sector grouping	Principal activities
SIC92 Group 65	Central banking Banks Building societies Other financial intermediation (leasing, credit granting, investment trusts, venture capital companies)
SIC92 Group 66	Life insurance Pension funding Non-life insurance
SIC92 Group 67	Administration of financial markets Security broking Fund management Lloyd's underwriting brokers; managing and underwriting agents of Lloyd's syndicates

The sector is very heterogeneous, but it is usual to group activities into retail services (banking, finance and insurance products developed for personal investors, small businesses and smaller corporate clients) and wholesale/investment services (banking, finance and insurance products developed for large corporates, public sector and governments). Currently, retail investment and savings services take place within national boundaries, although movement to a pan-European market is expected in the near future. Wholesale/investment activities are increasingly becoming international and global. This has been facilitated by the use of technology for which the sector is a major user, although, across the sub-sectors, developments in converged information technology and communications (ICT) vary.

Regional distribution figures of employment in financial and business services in 1997 indicated that around 45% of banking and finance jobs and 41% of insurance jobs were located in London and the South-East (Hasluck,1999). This relates to London's key difference as a financial centre from other UK cities, in that it is the location for:

- international financial markets
- head offices of many financial institutions
- the Bank of England
- representatives of foreign financial institutions
- a large, highly skilled workforce

The UK's prosperity is directly and indirectly linked to London's strength as an international financial centre. This strength depends on its ability to innovate, satisfy demand, and retain, if not increase, its competitive advantages over rivals. Currently, it is maintaining its competitive edge (CEBR, 1999). In circumstances of global competition, however, there are threats to the City of London's prominence with the rise of a global information economy (Thrift, 1999).

1.3 Details of Cases and Methodology

We have chosen cases to represent maximum diversity in terms of type of institution, product ranges, market segments and consequent skill requirements (see Appendix 1). Because of the diversity of the sector we were unable to capture its entirety in our eleven cases, nor were we able to gain access to all types of organisations we approached. However, the achieved sample is broad and comprises:

- Three organisations - a US bank, a UK bank, and a global firm straddling banking and another sector - which undertake one or more activities in the areas of corporate/commercial/wholesale banking, merchant/investment banking, stockbroking at national, European, international and global levels.
- Three institutions - two banks and a building society - that provide retail financial services at national levels through the branch network and other channels.
- Five cases operating in the London Insurance Market, four of which are composites. Although the project was supported by Lloyd's, and the International Underwriting Association, there was only limited co-operation from individual companies themselves. The case reports Finco8 to Finco11, therefore, cover interviews with representatives of HR, management, and operational employees from a selection of firms in each part of the London Insurance Market.
- In addition, three of the cases (Finco3, Finco4, and Finco6) operate telephony call centres, and we propose to draw out the common features regarding skills in call centres.

We have clustered the cases to represent major divisions in the sector: wholesale/investment banking and financial services, retail banking and financial services, and the London Insurance Market, treating wholesale and retail banking together in Part B and the London Insurance Market in Part C. In some of the cases we were able to obtain information about a range of business activities (Finco1, Finco2, Finco4), and in others we focused on specific areas (Finco3, Finco5, Finco6) that were regarded by these organisations as critical to their business.

A large number of firms we approached felt unable to participate. Pressures induced by the markets within which these firms operate and restructuring issues largely explain this. However, there also seems to be a widespread reticence about the importance of skill issues. Others who have conducted research on the sector have encountered similar attitudes.

Information was first collected on the sector and interviews were undertaken with industry experts to gather views on current and future developments. These were used to provide a background paper. For developing the case studies, the research team used a common interview schedule, derived from the overall research programme. This involved collecting background information on each firm and then face-to-face interviews based on a series of questions on:

- The product market and competition
- Knowledge and skill needs
- Skill availability and external recruitment difficulties
- Internal skill gaps and skill development
- Future developments

Relevant questions about HR planning, job design, skills monitoring, recruitment practices, pay, and training were incorporated within these.

Six members of the team were responsible for the interviewing and writing up of cases, using the common schedule for both the interviews and structuring the written case. The number of interviews ranged from one with the HR Director in Finco7 (a case which withdrew) to fifteen in Finco1 and 4. Face-to-face interviews were held with senior operations management, HR and training professionals, supervisory staff and professional staff. The written cases varied in length from 15 to 52 pages, with an average of 30 pages.

Since case selection depended on the willingness of organisations to commit to the study, rather than on stratified sampling of firms represented in the sector, bias will exist. It is likely that firms who declined to participate are those who (a) are seriously under-performing and unwilling to expose themselves, or (b) think they have got everything right, and therefore have nothing to gain by committing time to such a project, or (c) have very tight resources and could not prioritise them for this study. The ones who participate include those who have under-performed or who have current difficulties, and who want to learn and improve. They will often have taken or be taking steps to remedy serious problems, and want to do better still.

One of the aims of the research programme was to undertake case comparisons. We attempt to compare companies within sub-sectors, but this was not always possible. For example, investigation in Finco4 covered a wide range of products/services and delivery channels, but in Finco6 the research was restricted to non-life insurance products sold through call centres. Similarly, while both Finco1 and 2 provided investment-banking services, their market segments differed, with Finco1 operating in global markets and Finco2 just beginning to move into continental Europe. However, although direct comparisons of performance are not possible, there are a number of common skills issues (control of risk, delivering shareholder value, directing mergers and acquisitions) that are raised.

PART B: WHOLESALE/INVESTMENT AND RETAIL BANKING AND FINANCIAL SERVICES

2. BUSINESS STRATEGIES

2.1 Sector Drivers for Change and their Effects

Global/international banking and financial services is a sub-sector undergoing unprecedented change, consolidation, and convergence. The main drivers for change here are:

- development and application of technology (especially ICT)
- development of innovative products
- world-wide economic growth (apart from periodic downswings, such as with Asia, and Russia)
- regulation

(i) **Technology** is bringing about a variety of new possibilities. The development and application of ICT has revolutionised parts of the sub-sector, with more developments to come. These include electronic markets for stocks and shares, currencies and commodities; the establishment of 24 hour markets for global trading; the provision of new channels for trading by internet companies (e.g. E*Trade and Charles Schwab); and real-time processing such as changes to settlement processes. Global information, global money transfer, and opportunities for dealing in a variety of instruments and commodities, have been made possible by technology developments and applications, with a concomitant increase in the speed of change.

(ii) **Innovations in products** include developments in Euro-currency techniques (including swaps, FRNs (Floating rate notes) and NIFs (Note issuance facility)), hedge funds and OTC ('over the counter') derivatives.

(iii) World wide **economic growth** has led firms to move into expanding markets. For example, the European Union is creating an internal financial market with open access to financial organisations operating in member countries, and with the Euro as the new currency for most members of this market.

(iv) The sub-sector is strongly influenced by **regulatory controls**. These include progressive de-regulation (with recently, the dismantling of the Glass-Steagal Act in 1999), the liberalisation of trade and services, and the Basle Agreement of 1988, which raised the capital base of international banks with the aim of reducing their risk profile (this is currently under revision). This de-regulation and re-regulation has been driving market development and change across national boundaries. For example, while the FSA has been established to strengthen regulation post-Baring, the repeal of the Glass-Steagal Act in the United States, which reduced controls, may lead to a drift in the securities market to the USA where there is more capital also available.

Capital raising (e.g. subordinated debt, hybrid capital or Tier 1) is focused on improving financial efficiency. In the past, banks sought to improve their balance sheet and asset growth to increase profitability. But, since the Basle Accord, the emphasis is on asset productivity, capital efficiency and revenue growth. Tools for increasing financial efficiency include the use of securitisation, credit derivatives and M&A activity. The provision of tools for achieving capital efficiency is the main driver of the interaction between investment banks and their financial clients.

The key challenges for firms are to develop and implement growth strategies to create the critical mass and capabilities needed to operate in this sector, and to decide whether to specialise or offer a 'universal' facility. Major players are, therefore, engaged in mergers and acquisitions to extend their geographical influence, create an adequate capital base, improve cost structures, and extend their product range. Locational decisions made by global/ international players are, at the same time, strongly influenced by the nature of regulatory regimes.

In the retail banking and financial services sub-sector, the main drivers of change are:

- de-regulation and re-regulation
- intensified competition
- ICT developments and applications
- increasing customer sophistication

(i) Structural deregulation has facilitated wide-scale diversification across institutions, so that banks, building societies, and insurance companies are now able to offer a mix of products/ services developed through mergers, take-overs, conversions, or new business development.

(ii) Since financial services are relatively profitable, in spite of the sector having excess capacity, new entrants, offering innovative products/services delivered in new ways, have intensified competition

(iii) Structural changes have been augmented by technological developments and applications. Cash and bank points, credit, debit and smart cards, and telephone banking/insurance have occurred alongside a reduction in the number of high street branches (particularly with banks), leading to a change in their role and profile. Technological developments have also improved the processing of financial information through credit scoring and computer monitoring of accounts

(iv) In this competitive, complex and fragmented sector, with new entrants competing with established players, increasingly affluent customers are becoming better informed and more financially aware. Regulatory changes, privatisation issues, and tax incentives have stimulated interest in a variety of savings and investment products. At the same time, customer loyalty is eroding as options increase, although much customer inertia still prevails.

In addition to these specific sub-sector influences, both sub-sectors, at an organisational level, face a series of financial drivers, which are focusing attention on profitability. Banks seek to invest where returns are higher and a lower degree of risk is involved. Since lending now provides a relatively low return on investment, because of downward pressures on interest margins, banks are increasingly looking for businesses that involve selling services and know-how. This allows them to charge commissions and fees as an increasing percentage of total revenue. Additionally, new systems for measuring risk are being introduced to tackle the overall degree of risk exposure, and automation and outsourcing are providing significant cost savings.

Underlying the drive to increase margins and manage risk are pressures from investors and boards to deliver improved shareholder value. Expectations of 15 to 20% or more return on investment have been common, although the recent decline in market value of banking shares reflects a belief that such high returns may not be achieved in the future. Focusing on ROE and ROA has driven the creation of a number of new instruments to raise capital in an efficient manner.

Banking, finance and insurance activities are, in the main, currently profitable. However, increasing intensity of competition will influence the level of profit. Further threats will come from:

- other European/foreign financial service players entering the market
- new players (for example from the telecommunications industry)
- an increasing range of products becoming 'commoditised'
- processes of disintermediation whereby sophisticated depositors will lend directly to highly rated corporates, cutting out banks as intermediaries
- the increasing bargaining power of buyers (for example, where customers are able to make Internet comparisons of product prices and features)
- the Single European financial market and euro

Banking and financial services is currently a very fragmented industry, although some consolidation has been occurring. Technology is creating new delivery channels, new business models, and reducing entry barriers, while European economic and monetary union will enable customers to compare prices across the Euro-zone in the near future. This may lead to the creation of larger businesses able to use scale to reduce costs through further consolidation, across national borders. All of these factors threaten to combine to create a major shift in the market for financial services, with important implications for corporate and business strategy. A key challenge for institutions will be, therefore, to effectively balance expansion, profitability, and investment in IT infrastructure. The consideration of company responses below highlights the implications of these macro-developments for skills.

2.2 Product-Market Strategy Responses

Case firms have adopted a number of common features in their business strategy, which influence their responses to industry change:

- improving shareholder value through market focus
- cost reduction measures and increased efficiency
- improving customer focus and service
- positioning as a low-cost or differentiated service provider

Improving shareholder value through market focus

Firms have adopted a more focused strategy, operating in niche markets and 'cherry picking' through customer segmentation, in order to improve shareholder value. Having decided they cannot serve all customers in the market effectively, or necessarily all markets, they have been developing product/ market strategies to target specific segments with products/services that will provide them with the greatest revenues. These changes are summarised in Appendix 2.

For example, in the provision of retail banking and financial services, Finco4 has consistently been driven by shareholder value and, therefore, has a much longer track record for being highly focused in what products and services it wants to provide, and what markets it seeks to serve. Finco5 has more recently defined its market and re-determined its product/service offerings, focusing on core businesses and divesting others e.g. estate agency. Only now is Finco6 in the process of doing this. Its existing market is declining and a fundamental rethink is underway.

On the other hand, within the general strategy of focusing on market segments, Finco1 and 2 have been extending the range of their offerings and product portfolio, through mergers and acquisitions during the 1990s. Finco2 has developed strategic alliances with continental European partners and purchasing businesses (to acquire know-how in specialist services) to meet the needs of its major client groups, and both Finco1 and 2 have increased their investment in advice-giving.

New markets add to the opportunities for increasing shareholder value. Thus, the US-based bank (Finco1) has strengthened its presence in London to take advantage of new business generated by EMU and the Single Market, and both Finco1 and 2 have taken advantage of the growth of debt and equity markets by underwriting securities. Finco3 has likewise fundamentally changed its major client groups on identifying new business opportunities resulting from the effects of the introduction of the Euro.

Determining the scope of the business and developing appropriate alliance and acquisition strategies are high-level management skills. Some firms are clearly more adept and quicker at this than others.

Reducing costs and increasing efficiency

Information and communication technology (ICT) is also being utilized in a variety of ways to reduce costs and increase efficiency. For example:

- reducing levels of risk exposure
- improving investment decisions
- identifying profitable customer segments
- identifying unprofitable elements/ businesses for outsourcing or divesting
- transforming the nature of the retail branch network e.g. centralised processing of large volumes of transactions; ATMs enable customers to undertake banking transactions and obtain information about financial products
- providing expert systems for credit scoring and monitoring accounts
- providing systems to support the sales process
- software used in designing financially efficient products

Such developments put a premium on ICT skills, such that ICT increasingly underpins relative competitive performance. Companies whose senior management understand this are more likely to prosper that those that do not.

Improving customer focus and service

Traditionally, financial service firms have been product-focused and supply-driven. While a product-focus still prevails in the London Insurance Market, the picture is quite different in the other two sub-sectors, where there has been a gradual transition towards more customer-led, service-focused strategies. Telephone and Internet banking help to improve customer access to services, while client relationship management technologies help firms to develop an improved understanding of customer needs and better tailored products. Technology allows them to develop more flexible products/services and provide faster response times.

Brands, image and other intangible resources also signal the quality of product/service offerings. Thus, Finco5, a building society, is promoting the benefits of mutuality, using operating surpluses to offer better rates to savers and borrowers, rewarding customer loyalty, and using technology to support branch sales staff in delivering a strong brand image.

Much of the development in skills in banking has thus been around service delivery, and considerable effort and training has been directed towards staff and systems in this vital area of operations.

Positioning as a low-cost or differentiated service provider

Where an institution has decided to focus on part of the market rather than on the market in total, competitive advantage can be established by being a low cost supplier or by differentiation. This means creating a mix of meaningful differences, which enable the customer/client to distinguish products/services from those offered by competitors. Differentiation strategies utilised by the case firms include developing capabilities such as:

- operational excellence (operating the business better than competitors) (Finco1, Finco3)
- customer intelligence (superior knowledge of clients/customers, enabling faster response than competitors to changing client needs) (Finco5)
- product leadership (consistently producing or offering products that outperform those of competitors) (Finco4)
- relationship development (building and maintaining long term relationships through low turnover) (Finco2)

Such factors are of great importance in influencing customer/client evaluations of financial products/services today, with the need to add customer value in the face of product commoditisation, rising service levels, and proliferation of delivery channels (Knox, Maklan and Thompson, 1999). Appendix 3 summarizes the mix of approaches adopted in the cases. Other differentiation strategies include sophisticated risk management (Finco1); quality customer service (all case firms); high quality, competitively priced products (Finco3 and 5); strong branding (Finco4 and 5) and lifestyle relationship management (Finco6).

These examples indicate one of the major differentiators between firms, in all three sub-sectors - namely, the ability to re-invent or re-focus the organisation in anticipation of, or concurrently, with a changing environment - and the need for a variety of organisational responses to cope with changes on many fronts. These are top-level strategic skills. While the case firms are generally responding to the sector drivers, some have been relatively slow to do so, and their strategic aspirations must be in some doubt. These include Finco5, which has been slow to respond to technological developments; Finco6, which has been slow to respond to strategic marketing developments; and Finco4, with its very strong focus on cost reduction, which may reduce its future capabilities.

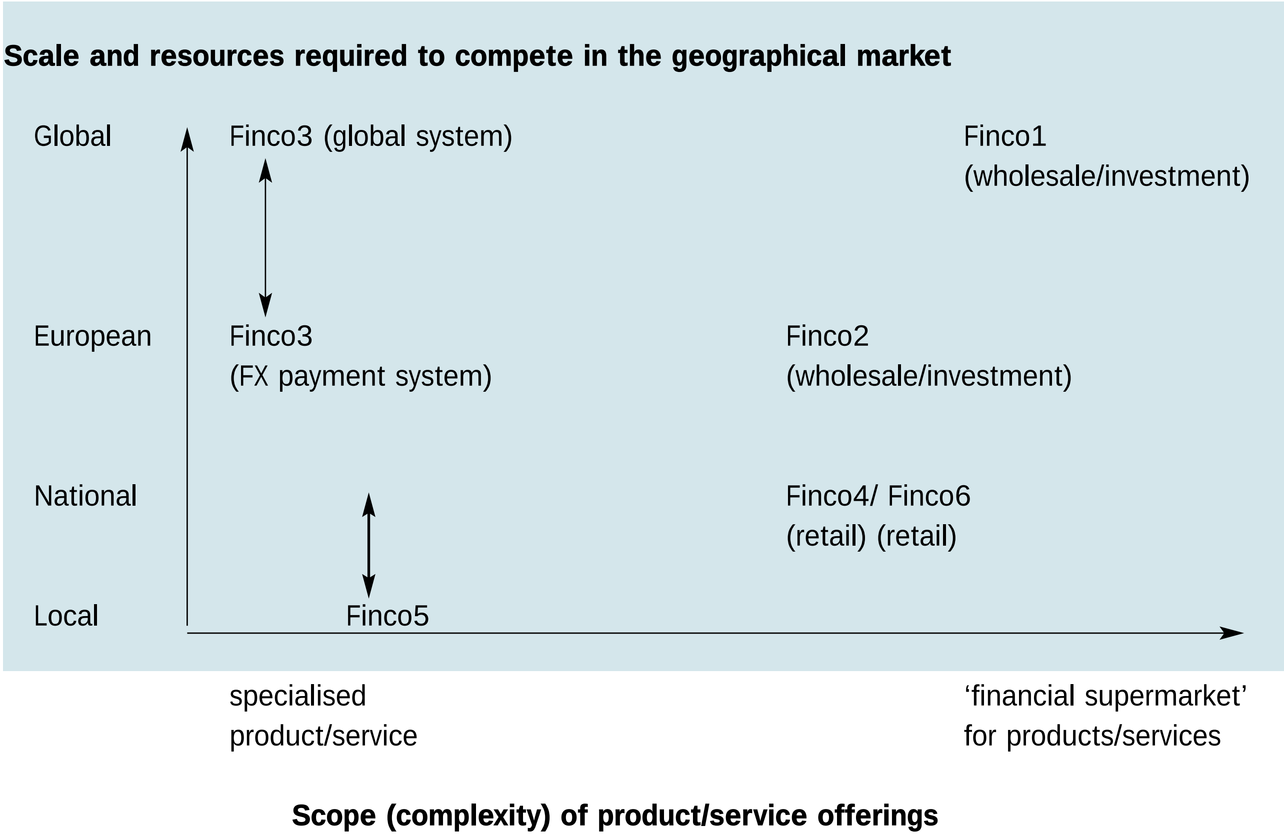
2.3 Nature of Product/Services, Delivery Channel Strategies, and Positioning of Cases

The ability of firms to reinvent themselves is reflected, at an operational level, in their approach to innovation in products and services, and in the channels for delivering these. Customer relationship strategies (often based on dividing the customer base into groups) and distribution channels are an integral part of the product/service offering. With increasing commoditisation (where new products are almost immediately replicated by competitors), opportunities for profit are dramatically reduced (Ernst and Young, 1999). As the cases show, firms may choose to differentiate themselves using customer relationship management, rather than by competing on the price, quality, and reliability of commoditised products. Each type of customer relationship implies a corresponding type of product offering, and different kinds of skill - ranging from single product (automated) transactions; through technical advisory relationships, focused round product and service bundles; to partnerships, where theme-based products and services are matched to changes in the customer's life-cycle. Distribution channels for these are also an important strategic consideration, with dramatic cost implications.

- At one end, *electronically-based services* (e.g. ATM, plastic cards) are promoted for basic, commoditised, high volume products, of relatively low risk, with features that are easy for customers to understand and evaluate. Often a single product/service, such as money transmission, is involved in a transaction completed by the customer, who may go on to undertake a further transaction such as checking the balance of an account.
- Further along the continuum, *technical/specialist advisory relationships* can be offered for a variety of products/services (e.g. loans, mortgages, insurance) through the branch or telephone, or by travelling sales staff, all with relevant technological systems underpinning the sales process. In these cases, staff/client interaction may be driven by the technology, with highly scripted routines, or staff/client interactions may be supported by the technology, allowing staff more discretion in engaging with the customer.
- At the other end, *professional financial services* require in-depth appreciation of client circumstances, or longer-term staff/client interaction, often involving teams of people with different skills. Specialist services (e.g. investment banking activities) are often high risk, highly intangible offerings, where a successful outcome depends on in-depth understanding of the client and their particular circumstances. These services, by their nature, need prolonged face-to-face contact between client and staff.

All the case firms offer some products and services along the whole continuum, at different levels of complexity (depending on whether the client is an individual, SME, MNC, or government), and utilise a variety of distribution channels. They also focus on different geographical markets - local, regional, national, European and global - which may influence their choice of distribution channel strategy, on account of the resources required. Figure 1 locates the cases according to their product/service offerings and geographical market.

Figure 1: Firms' Positioning and Market Strength



: indicates link with market through branches (Finco5) or parent (Finco3).

Banks, building societies and others offering specialised product/services will not require the breadth of skills needed by firms adopting a 'financial supermarket' model. Similarly, firms offering local and regional services are unlikely to need the level and mix of skills required to provide more complex forms of financial advice, compared with companies which cross national boundaries. Most UK retail products/services are, in fact, offered on a national basis, because tax, regulatory and other systems have not yet been fully harmonised across European borders. In investment banking, on the other hand, where company mergers and acquisitions take place across Europe (and beyond), individual and team skills for developing and delivering products and services must be broad enough to cope with the many differences in tax, legal and regulatory regimes between countries.

Low complexity products (to the left of the scale) can be delivered via technology, and high volumes and economies of scale make this cost-effective. Finco1, for example, is a world leader in transaction processing and supporting global custody products and payments. These products/services have very tight margins and timely and efficient execution, in a cost-effective manner, are the requirements for success. Similarly, Finco3's new business, providing corporate FX payment services, requires skills to develop the technology to cope with high volumes in a cost-effective way, and sales skills to generate sufficient new customers.

Retail banks, such as Finco4 and 6, are encouraging customers to undertake more transactions through the telephone and Internet, as the cost savings are considerable. To reduce internal costs, Finco4 has centralised computer operations and consolidated large-scale processing operations (including back office operations from all of its branches). This has delivered large efficiency savings, which are reflected in the substantial reduction in its cost/income ratio. Changes in the branch structure of Finco4, 5 and 6 have also resulted in the removal of non-profitable activities from potential sales space, and increased the need for staff with sales skills.

In the case of financial products at the commodity end of the spectrum, pricing is a factor, but not exclusively so, and none sought to compete only on price or offer top rates. For example, several interviewees in retail financial services referred to Egg's strategy of offering top investment rates, and argued that this was an unsustainable strategy. Marketing skills are therefore important to develop and promote brand awareness, and to provide additional features that are valued by customers.

The ability of firms to develop a sustainable product/market strategy depends, then, on their capacity to deliver a competitive bundle of benefits, or value, to the client/customer, while possessing the necessary resources and designing processes to effectively utilise these resources (including cost-effective distribution channels). Strategic marketing skills in understanding market developments and being quick to innovate in reshaping product/service offerings are, therefore, critical, along with HR strategies to implement these.

2.4 Skill Implications

To summarize, then, in the *wholesale/investment banking* sub-sector (Finco1, 2,and 3) the drive to achieve scale in raising capital, develop new products, provide advisory services and manage risk while concurrently increasing shareholder value, reducing costs and capturing efficiency savings has implications for skills, as follows:

- Top management continue to need skills to identify firms with whom they can develop alliances, partnerships, mergers and friendly take-overs and manage the relationship or integration successfully.
- High-level technical skills are increasingly needed for developing complex financially efficient products.
- Team skills or hybrid skills are needed in the growing activity of providing advice. Here, the nature of the advisor-client role is moving away from the 'expert/ telling' role towards the 'consulting/ partnering' style.
- Investment activities and knowledge are increasing in importance.
- Risk management skills to support overall business activities are vital at the corporate level.
- Information technology skills of the highest calibre are required to develop ever more intricate systems that (i) support banking and finance activities at the global level, and (ii) deliver efficiencies and cost savings.

In the *retail banking and financial services* sub-sector (Finco4 to 6), technological developments, the drive to cut costs, and reductions in the branch network have changed the nature of the work that staff are required to undertake, with implications for skills, as follows:

- Firms need data entry and clerical skills in processing and other back-office functions, which have not yet been fully automated.
- Sales skills are needed in branches, as staff are expected to engage in cross-selling while, also, successfully managing the client relationship.
- Call centre staff need telephony skills currently, but as more firms move to multi-channel centres, broader skill-sets will be needed.
- Product development skills are essential, since sales are influenced by the quality of the products/services.
- Strategic marketing skills are important because of the need to develop brand image especially with the move towards Internet business.
- Specialist information technology skills and hybrid technical/business skills are of critical importance since technology underpins many key operations, products and services.
- Change management skills are critical in established firms that are seeking to become more flexible and responsive. Linked to this, is the need for significant staff attitude change.

2.5 Assessment of Sustainability of Product/Service Strategy

Deloitte Consulting (1999) argues that to survive in the sector, firms need to develop sustainable advantage and build sustainable capabilities (i.e. focused, flexible systems and staff that can adapt to future conditions) by:

- *Building customer focus into the organisation* (many are still currently hampered by functional and product line silos and disjointed distribution channels).
- *Valuing employees* ('people being our greatest asset' is still merely a slogan for some, and there is a need to improve recruitment and development processes).
- *Shifting IT investment to strategic applications* (by combining 'data mining' with sophisticated call centre technology, so that as a customer makes contact, his/her profile appears on screen, along with instructions for the perfect sales or service strategy).
- *Coping with intensifying mergers and acquisitions.*
- *Meeting the Internet challenge, as more transactions migrate online and as the online channel acts as an information gateway* (so that customers can access investment information and compare prices themselves).
- *Continuing to make essential cost reductions, but within a wider strategic framework.*

Case firms differed in the extent to which they were successfully addressing these challenges.

Building customer focus into the organisation

All case firms had focused on particular markets and customer segments, and were developing capabilities to underpin this, but were doing so in different ways and with varying degrees of success and sophistication. As a means of breaking down functional barriers, Finco1 was making efforts to re-organise along business process lines for some activities. Finco2 deliberately did not encourage cross-selling, and kept its businesses autonomous. Long-serving staff who had in-depth knowledge of particular sectors, and had built relationships with customers from those sectors, were the source there of enhanced customer focus.

Shifting IT investment into strategic applications

Banks are unusual in that they perform both input and output functions. The ability to collect and utilise customer information is therefore key. In branches, staff use PCs while interacting with customers, and the system can provide them with information about the customer for a ‘soft’ sales approach.

Similarly, *call centres* use computer and communications technology to help staff answer customer queries and sell services. Banks are slowly adopting integrated technologies, in ‘total communication centres’, through other media in addition to the telephone, and undertaking outbound calling. The three cases in retail financial services were at different points along this trajectory. Building societies and insurance companies in general are lagging behind banks in using the full capacity of call centres (Building Societies Association, 1998), and Finco5’s call centre, set up two years ago, was relatively new in comparison with those of Finco4 and Finco6.

Finco3 was the most developed towards developing a full communications centre. It had invested heavily in systems for FX payment business, and the design of its web-based technology had won widespread acclaim. Finco1 and 4 had also developed web-based systems that provided products/ services and captured information. Finco4 had technology that gave a full view of the customer, and Finco5 was moving in that direction. But Finco6 had yet to develop such a facility, and was still product-focused and structured along functional lines. Although its specialist technology was considered advanced, it did not have the ability to collect customer intelligence through its marketing information systems, and this was a significant disadvantage.

Meeting the Internet challenge

To combat competition, deal with regulatory changes, and control costs, financial service companies are spending more on marketing and information technology, and this is increasingly focused around the new opportunities they see in *e-business* (PriceWaterhouse, 1999). Recent analysis found 682 UK sites among financial service providers using the Internet (Mintel, 1999). 38% of these were intermediaries (comprising independent financial advisers (IFAs), mortgage brokers, and insurance brokers), 25% money transmission and credit companies, 20% investment companies, and 18% insurance companies and life and pension companies.

As we noted above, Finco1, 2, and 3 provide services through the Internet, and Finco4 and 6 also offer some form of on-line banking. Finco5, however, did not offer a web-based service. Since

Internet services are cheaper to operate than branch networks, customers expect to obtain better rates than through traditional channels. A lower-priced service, however, reduces the total cost savings to the financial service provider.

Developments in the Internet as a distribution channel, moreover, contribute to processes of 'dis-intermediation' - that is, they allow alternative providers to set up direct operations and by-pass intermediaries. The overall effect is to reduce entry costs to the market. As a result, the Internet is changing banks-to-business relationships, and leading new entrants to seize the opportunities provided. One such area is the payments business. An example of this is to be found in Finco3, which is developing an Internet-based international payments system. This helps commercial organisations make foreign currency payments to companies in other countries, and provides for the efficient handling of foreign currency payments received. A recent report suggests that 10% of a bank's profits is generated by its payment business, and new arrivals threaten this business if they can offer to process payments more cheaply and efficiently. Companies based in technology that may threaten banks include Microsoft, Dell Computer, SAP and Cisco Systems. Microsoft and the Governor of the Bank of England have both commented that "while banking is essential, banks are not".

Cost reduction within a wider strategic framework

Most of the cases are following the trend to reduce costs by cutting employment. For example:

- Finco2 sheds people after undertaking mergers and acquisitions.
- Finco4 has already undertaken a substantial reduction in headcount, and will continue to do so as it reduces the branch network.
- Finco3 expects a reduction in headcount with the introduction of its new payments system.
- Finco5 has, for the first time, recently experienced compulsory redundancies as a result of head office restructuring.

As in other sectors, downsizing and business process reengineering have also contributed to reductions in headcount. It is also likely that Finco4 and Finco6 will continue to shed staff through branch closures, as they share a similar profile to other UK banks. As an indication of the scale of what we might expect, it has been suggested that competitive advantage will accrue to those who can reduce the size of their branch network to around 500 (from current levels of around 1700 or more), as this is sufficient to give other kinds of retailer national coverage (Lex, 2000).

However, the balance between scale, profitability and investment in technological developments varies, and in their attempts to build shareholder value, an institution's sole obsession with costs can become destructive.

A common over-simplification in financial service companies has been to equate value creation with cost-cutting. More astute firms are creating shareholder value by using their information to increase the 'lifetime value' of customer and product profitability on a risk adjusted basis. (Andersen, 1999).

We have presented some evidence above of differences in the balance being achieved between cost-cutting exercises and initiatives to exploit proprietary information (through customer segmented data), and we will elaborate on this in subsequent sections.

A number of organisations are using the balanced scorecard to encourage attention to market share and qualitative indicators of performance, such as customer satisfaction, while Finco6 uses a balanced scorecard approach to encourage innovation and improvement, through the development of people and products.

To summarize evidence on the sustainability of their strategies, then, we can say that:

- Finco1 and 2 seem to be in a strong position in high growth markets in some of their major businesses for the foreseeable future.
- Finco3 seems to be successfully establishing its position in a newly growing market.
- Finco4 is in a strong position in a relatively mature market.
- Finco5 is building its strength in its niche market, where it holds a relatively stable market share.
- Finco6 holds the weakest position.

3. SKILL NEEDS AND DEFICIENCIES

This section assesses the extent to which case firms have the capacity to translate business strategies into skill needs. In effect, what are their strategic planning processes and what is the relationship with HR planning? How do firms identify future skill needs and changing skill needs as the business evolves? In addition to assessing their planning and identification of skill needs, we also examine their capacity to meet skill needs through HR processes. We begin, however, by detailing their present skill needs in relation to key areas of functional activity (that is, excluding high-level management skills).

3.1 Specialist Skill Needs

All the case firms have sought to identify changes in revenue patterns and, based on projected revenue streams, the activities, products and services, technology and skills they will need to achieve their objectives. We particularly sought their views on what critical skills were involved in developing and securing these. The following details these, classified in terms of specialist (occupation-specific) skills and hybrid skills.

(1a) Specialist (occupation-specific skills) in wholesale/investment banking

- Analytical skills are critical in the burgeoning area of *investment management* (the servicing and safekeeping of assets for large funds, including pension funds, unit trusts and insurance companies).
- Regulatory change has increased the need for analysis of portfolio returns and performance comparisons with competing firms.
- Specialist financial advice is needed for increasing numbers of wealthy individuals with private banking on, for example, tax-efficient investments.
- In the expanding *corporate finance* area, the important skills are the provision of strategic financial advice to corporations, engineering ‘deals’, and in-depth knowledge of client businesses and markets. Current market knowledge includes an understanding of types of financial structures acceptable in the market and pricing correctly and, therefore, competitively.
- Related to this, in-depth sectoral knowledge is important for identifying and securing new business with fast-growth firms that might need banking services.
- Skills in financial analysis are needed for assessing client performance against a range of factors for the purposes of corporate lending. Risk assessment and the appropriate structuring of loans are also part of this skill-set.
- Foreign exchange dealing and derivatives trading in *capital markets* require skills in quantitative finance and a strong understanding of risk; also, an ability to take in information quickly from a number of sources (from the screen, telephone and colleagues), and to make split-second ‘buy and sell’ decisions. Developing innovative products in derivatives is also critical.
- Sales skills are needed to recruit clients directly, rather than through intermediaries (in private banking/asset management, and in corporate FX). This means the development of a sales culture with staff actively soliciting business.

(1b) Hybrid specialist skills in wholesale/investment banking

- Corporate lending also needs a combination of specialist and marketing skills to sell services to the top management of large corporations.
- The design of systems to deliver products/services via the web requires a combination of IT/IS skills, business knowledge, an understanding of customer requirements, and product knowledge.
- This kind of skill-set is necessary also to identify e-commerce business opportunities.

Why are these skills rather than others needed in the wholesale/investment banking sub-sector? A number of factors have been responsible. For example, ICT, together with de-regulation, has driven a significant increase in cross-border financial transactions and fast growth in international financial markets. A strong increase in competition has led to a move to increase capital market activity rather than lending, and an increased importance of off-balance sheet activities such as the use of derivatives, proprietary trading and asset management (OECD, 1996).

Generally, the scope of banking activity is broadening. This results in the development of new products (e.g. origination and servicing of securitised assets and derivatives); improved efficiency in distribution of existing products; increased revenues emanating from fee-based services; and moves into more profitable areas such as investment banking and risk arbitrage. Additionally, because banks are now holding a wider set of financial instruments, skills are needed to continually manage various types of risk. This involves comprehensive measurement and information systems for monitoring, reporting and controlling risk, with consequent skills needs for financial analysis, for innovative products such as OTC market instruments, and for derivatives.

(2a) Specialist (occupation-specific) skills in retail banking and financial services

- In addition to responding to direct enquiries and complaints, branch and call centre staff need to be able to identify sales opportunities and pass on sales leads to other staff. This requires a knowledge of products. Some products (and staff) also require a knowledge of regulations to meet compliance standards.
- Selling products in the face-to-face situation needs different skills to selling products over the telephone.
- A knowledge of marketing in retail environments is needed to differentiate products and services
- Customer service skills are needed when undertaking administrative activities such as changing client records (via different media). These are critical to the quality customers experience in the 'service encounter'.
- Senior adviser skills are needed for dealing with irate customers, and include 'emotional intelligence' and complex problem solving skills.
- Regulated sales skills especially hold the key to profitable business. Firms are aiming to equip staff to deal confidently with increased regulation and to achieve a higher degree of cross-selling.

(2b) Hybrid specialist skills in retail banking and financial services

- Strategic marketing software skills are needed to build data warehouses and develop ways of mining data.
- Product development teams need financial understanding, combined with marketing knowledge, channel appreciation and creativity.
- Change management teams need business knowledge, project management, and skills in system design and implementation, especially in staff/technology interface considerations
- Hybrid IT/IS skills are needed by the business to ensure leverage of existing technology and developments in infrastructure.

Why are these skills needed in the retail banking and finance sub-sector rather than others? Since cost/income ratios generally need to be reduced, and staff costs are the greatest expense, the branch network has evolved to include a number of the following (Rajan et al, 1999):

- Internet/on-line banking and financial services
- call centres
- processing centres
- area offices (in urban areas, providing a range of corporate and private banking and financial services)
- satellite offices (suburban and rural high street branches, with mini-branches in other locations, such as supermarkets)

Processing centres undertake back office functions generated by other structures, with repetitive and highly controlled series of tasks. This has created economies of scale for retail banks, but means that staff are merely required to undertake simple tasks, such as entering data. In contrast, branch staff have had their 'teller' role changed into the 'seller' role. Since benefits are believed to derive from relationship management, based on the concept of 'lifetime value' of a customer, branch staff are expected to engage in cross-selling and enhancing the customer relationship. This active role means that sales are, in part, dependent on branch staff skills.

However, sales are also influenced by the quality of the financial savings and investment products, which depend on the skills of product development teams. Innovation in products entails being first to market - although usually at a high price - with the intention of capturing early adopters and matching potential client needs with emerging product capabilities. These skills can be found in the best marketing departments. Strategic marketing skills are of great importance, with the need to develop brands and give customers a consistent image, regardless of the communication and distribution channel used.

Since technology underpins many key activities, professional technology skills are needed, and hybrid technical/business skills are essential to utilise technological potential within the business. Call centre staff now undertake a high proportion of retail banking and financial service activity, and they need to be able to sell products and services over the telephone or interact with customers through the Internet. An important organizational competence, which established firms need to help them change quickly, is change management.

3.2 Capacity to Translate Business Strategies into Skill Needs

Across the three sub-sectors, firms have traditionally planned for the short term. There is some evidence that managers are becoming aware of the need to take a longer-term view. For example, Finco4 has a dedicated unit monitoring employment trends over time, and feeds this information into the business planning process. Similarly, in Finco5:

We have tended to plan for the short term in the past, and not looked ahead enough. The need to look ahead is becoming increasingly important. If we are not planning 3 to 5 years ahead, we will never make decisions on technology - whether to invest in the Internet or digital television (Finco5).

And this is recognized as having skill implications:

If we move into these distribution networks, the skill requirements for sales staff (the majority of whom have in the past been money-transactors) will be quite different with these new technologies (Finco5).

In all cases when management was formulating its business strategy, skill implications were a secondary consideration. Nevertheless, although skills are not currently considered a priority when developing business strategy, they are not ignored:

Some account of skills is taken, although not directly. When considering future strategy we do consider our business competences and strengths - that is, what we are good at - which obviously includes our skills base, but also many other factors, such as technology, relationships and positioning. But strategy comes first. For example, the decision to go into e-commerce came first. Then we recruited people and identified skills gaps. (Finco3)

What makes skill planning difficult is the uncertainty regarding the rate at which products/services will be taken up within the newer delivery channels.

For international firms such as Finco1, HR planning may be across national boundaries. Different HR planning horizons may then be linked to tiers of recruitment, with plans at international, national and regional levels. This tiered approach is becoming more defined in banks, as junior staff are recruited to use systems and trained for product knowledge, while senior management are recruited to develop and manage systems and sales, and for their technical skills.

In Finco2, strategic planning identifies teams or whole firms for acquisition, which will enhance its skills. This reflects common practice in some areas of investment banking and the London Insurance Market, of poaching or buying-in skills rather than developing them in-house. The cost of this is not a primary consideration.

In the larger firms, planning tends to be formal, and connections between strategic and operational levels were experienced as weak, with planning imposed from the top. In Finco5, however, planning is a “lived process”, with the top team and other managers required to present, defend, negotiate and agree their decisions at different levels in the firm.

3.3 Capacity to Meet Skill Needs

A resource-based perspective on competition (Koch and McGrath, 1996) argues that certain HR strategies will bring about superior workforce performance. Overall HR sophistication is seen to result from investments in HR planning, in recruitment and selection, and in employee development.

- **What investments have case firms made in recruitment and selection processes?**

Recruitment and selection can deliver value when it increases knowledge of the labour market to inform hiring choices. Most companies had some system for this, ranging from niche market businesses where people were known personally or by reputation (Finco1, Finco2), to formal units that produced quantified information for the Group (Finco4).

Finco2, with businesses operating in niche markets, chose not to advertise, but to fill posts through personal contact. If a vacancy needed to be filled and a suitable person had not been identified, an agency might be used. But here, and in similar businesses, with relatively few competitors employing people with the required skills, potential candidates were often known by reputation beforehand. In addition to technical skills, the ability of the person to fit with an existing team was very important, and therefore attitudinal and personal attributes were important. Personalised recruitment worked because each director was responsible for his/her own business, and therefore very motivated to recruit the right staff.

Finco1, 5 and 6, on the other hand, were investing in a wider range of recruitment sources, to generate a greater number of applicants and reach different pools of potential applicants. In Finco4 and Finco6, workplace simulations used to predict performance on the job had been revised to improve the selection process.

- **What investments have case firms made in the provision of training and learning?**

Investments in employee development, via the provision of training/learning opportunities and the utilisation of promotion-from-within to fill vacancies, was also examined in terms of the extent to which processes produced skills that were firm-specific. Some parts of the sector have been particularly prone to high-profile raids of individuals and teams with easily transferable skills, especially in the London Insurance Market and in Finco1 and 2. When firms develop people with skills that are idiosyncratic to that environment (Finco2), this is less likely to happen.

In all cases, organisations have chosen to move responsibility for career movements and career development to the individual. The amount of support provided for this varied, with Finco5 being particularly strong in supporting staff.

While formal training has been a high profile activity for many financial institutions, (and in all our cases except Finco2), some are now focusing more on learning rather than training (Finco4, Finco5, Finco6).

Competency frameworks tended to be introduced as part of a response to wider organisational developments including:

- changes in working practices, with a greater focus on team working and customer service
- flatter organisational structures, providing less opportunity for traditional development through promotion
- cultural changes, leading to a greater emphasis on employees taking responsibility for their learning and development
- the introduction of increased flexibility in work, requiring staff to develop a wider range of skills

- **Are future skill needs identified? How?**

Future skill needs are identified by individual managers and through formal mechanisms, with most emphasis in all firms on informal means. These include personal contacts within the industry; membership of professional associations, technical information provided by colleagues, and listening to clients. Organisational structures for picking up intelligence on future skill needs include:

- monitoring the competition for opportunities and threats (Finco4)
- monitoring market demand and the use of IT (Finco4)
- talking to focus customer groups (Finco4)
- joining business forums (e.g. Call Centre forum representative) (Finco4)
- conducting exit interviews (Finco4, Finco5)
- monitoring new technology and its implications for training (Finco5)
- reviewing existing skill sets and internal skills development (Finco5)
- involving HR professionals in the business units

As this list indicates, Finco4 and 5 in retail financial services were particularly active in picking up intelligence from internal or external sources. Others, however, were still quite insular (and could not, for example, identify comparator best practice firms). This can prove problematic, and in two of the cases late recognition and responses to sectoral challenges (which has become critical in financial services (Youngman, 1999)) had led to poor firm performance and the removal of senior managers.

- **Did case firms see value in educational and professional qualifications?**

Firms in the *wholesale/investment banking* sub-sector differ in their appreciation of qualifications. Since Finco1 has been increasing the provision of value-added services, qualifications have gained in importance in many of the critical functions. This has resulted in increasing employment of graduates and people with professional qualifications where experience was previously the main requirement. However, in Finco2, teams and firms are judged on their track record, and qualifications are viewed as immaterial. Finco3 has a similar pragmatic stance. In addition to technical qualifications, Finco1 ask for managerial experience and qualifications (such as an MBA) for posts in sector analysis and investment banking. Quantitative analysts need PhDs, and professional qualifications in law or accountancy are considered important in corporate finance teams. The skill needs identified in Section 3.1 thus entail some highly-specific, high-level technical skills, but others that are broader, which are met either by combining specialists in teams, or by emphasizing the value of experience.

In retail *financial services,* qualifications required have changed as the business has changed. Institute of Bankers (now ACIB) examinations were once critical for advancement in banking, but now they are ‘nice to have’ rather than essential, since retail banks now have a wider spread of products and services. With overall knowledge of banking diminishing, and the rise of specific skill-sets, other qualifications are becoming important. A range of qualifications has been developed for selling and advising on financial services/products and general insurance. In the retail sub-sector (Fincos4 to 6), these include the Financial Planning Certificate (FPC) and its equivalent (IAC, CeFA) for regulated salespeople. Regulatory authorities accept this qualification as proof of a basic level of knowledge required to become a financial adviser. CMAP (Certificate of Mortgage Advice and Practice) is a qualification for those selling mortgages, and other qualifications (supported by the Call Centre Association) are available for those specialising in call centre work.

The FSA's (1999b) Training and Competence Sourcebook (Appendix D) lists approved examinations for a variety of activities in *investment banking and corporate finance.* The FSA, through its Training Advisory Panel, intends to look further into training and learning issues affecting the sector.

3.4 External Recruitment Difficulties

Table 2 lists areas of recent recruitment activity. In all cases, recruitment has been linked to business growth, although in call centres recruitment is also linked with high staff turnover. Target numbers are generally small in percentage terms, although, not surprisingly, in larger organisations, large numbers of recruits are sought (for example, 100 regulated sales people in Finco4, representing 0.2% of existing staff numbers).

Since demand is largely a function of economic activity, where this changes, so too does the profile of the business. The continuing high performance of the US and UK economies means that demand is, generally, currently high. During 1999 and this year, Finco1 and 2 have been recruiting to meet the demand from merger and acquisition activity, the growth in investment management, and the need for private equity/venture capital in a buoyant economy. Finco2 has been seeking to recruit teams, rather than individuals, for such business areas as private banking, as these are predicted to grow in importance and need to be developed.

Banks are also hiring staff to strengthen their European operations, in anticipation of more restructuring and industry consolidation. However, businesses are also prone to downswings. For example, the Asia crisis a couple of years ago, the Soviet economy last year, and problems in the derivatives market, meant that jobs were lost in some areas of investment and merchant banking in 1998. This can be abrupt, and a major contraction is never far away:

The key lesson from the market wobbles in 1998 is that the investment and banking industry is just one equity market crisis away from a sharp drop of business in its most profitable businesses. In particular is the worry that leading investment banks have been relying too much on their proprietary trading and investment activities including private equity funds. (Lewis and Pretzlik, 2000:4)

- **What is the relation between recruitment and labour turnover?**

Firms generally report low labour turnover figures, and in several cases, turnover was regarded as too low, particularly when they were trying to introduce cultural change. Regional differences occurred in retail branch networks, with London experiencing much higher rates of turnover than the North West. One reason for low turnover figures may be that business expansion has been accommodated, to an extent, by the assimilation of 'surplus' staff following mergers in three of the cases. The exception is call centres, where there are also regional differences. In Finco4, turnover ranged from 10% to 21% according to location, (with the average rate of turnover for call centres being 20%).

Table 2: Some Evidence on the Extent and Causes of Recruitment Needs

Case Company	Key skills/skill areas	Target nos.	Reasons for recruitment
Finco 1.	Internal auditing Portfolio managers Corporate finance Global markets Corporate lending Global investment services	2 30 17 50 100	Normal turnover Business expansion 5-10% per annum growth due to business expansion Seeking more credit analysts Growth and acquisition
Finco 2.	Merchant banking activities	350	Acquisition of company as means of recruitment
Finco 3.	Call centre selling and Helpline IT project managers	 12	Seasonal change Developing E-business
Finco 4.	Regulated sales people Call centres Customer service and Regulated and non regulated Sales Low grade machinists and mailroom (manual ops) Line manager/team leader Senior managers	100 120 500 70 6 6	People leaving or changing position and/or area Turnover and burnout Business moved to new area Established new centre in SE For new centre For new centre
Finco 5.	Customer services Senior management	few 2	Natural wastage New posts
Finco 6.	Call centre operatives	18	Turnover
Finco 7.	IT specialists Underwriters Claims clerks Client team Professional specialist	2 2 2 4 1	Business growth
Finco 8.	High level technical Business development Managers		Strategic desire to enter new niche market Compliance and demands of Capital providers
Finco 9.	High level technical Business development managers		Business growth and demands of capital providers To manage change
Finco 10.	Skilled information workers		To resource the need to broaden the product offering
Finco 11.	Processing workers		Cyclical demands of business

- **What is the nature, causes and impact of recruitment difficulties?**

Skill shortages found in the wholesale/investment banking and finance sub-sector included computing languages requiring Java, complex sales and trading functions skills, asset management and investment advice for certain industries (such as media and telecommunications). Some of these shortages arise when there are relatively few people with these skills in the market and this coincides with 'hot' markets of peak activity. Skill shortages in retail banking and finance were relatively few and included change programme managers, which is a relatively new role in organisations.

Skills can prove problematic to recruit when, for example, firms are unwilling to train and are seeking large numbers from the market (such as regulated sales staff), or when financial firms are not located in clusters and people take a risk moving outside London or other large financial centres. Recruiting people with language skills into call centres can be difficult because of the perceived unattractiveness of the work.

Recruitment difficulties also related to tight local labour markets. In three cases, moves to an area with a very good skills base had been counterbalanced by either other, similar, firms moving into the area, or different firms concurrently experiencing business growth generating a need for similar skills (often involving lower-level clerical staff).

Companies applied a range of solutions to deal with recruitment difficulties, the most important of which are:

- Improving school/university links
- Taking advantage of other firms downsizing
- Using contractor and temporary staff
- Outsourcing
- Relocating
- Changing person specifications
- Increasing the search area

Larger firms tended to have formal systems for recruitment supported by HR specialists. In the wholesale/investment banking sub-sector and in the London Insurance market, line managers sought candidates (and teams) for selection on both their track record and likely ability to fit the existing team or structure. However, because some firms in the industry have failed to establish systematic recruitment systems, the FSA is insisting that firms falling under their regulation will be required to make improvements (FSA, 1999).

The perceived importance of recruitment difficulties varied within and between cases. HR specialists and line managers often took a different view from senior managers, who did not see recruitment and retention difficulties as a major problem. HR specialists suggested that recruitment difficulties are likely to have created 'hidden' costs. For example, while performance may not seem to have been affected in the short-term, there have been increasing and cumulative pressures on staff (through longer working hours, often unpaid, and dealing with increased dissatisfaction of customers). Research has shown the negative effects of long hours on employee health and its adverse effects on productivity (Worrall and Cooper, 1997).

Specific consequences of recruitment difficulties include:

- where senior managers have not been in post and this has delayed important commercial decisions (Finco5)
- unmet sales targets because sales-staff have not been appointed (Finco4)
- slower product development and business growth, through being unable to acquire niche teams that are seen as the engines of growth (Finco2)
- opportunity costs in call centres, through managerial time being spent on recruitment, induction and training to cope with high labour turnover (Finco4)
- direct costs from a shortage of IT professionals (Finco4), and having to pay premium rates to agencies
- additional costs because high demand for specialist skills has meant being unable to deliver front-line customer service systems (Finco5).

Retention problems are most likely with ICT and IT/IS groups, where 'hot' markets develop and skills suddenly become in demand. The result is skilled people are poached - for example, with Web and network skills involving experience of specific areas of banking and finance, such as FX and commodity trading systems. Such problems have slowed implementation programmes in Finco1.

3.5 Internal Skill Gaps

- **What is the nature and causes of skill gaps?**

Skill gaps can be defined as 'the discrepancy between the actual level of skill in the workplace and that ideally required given the available technology and state of the product market' (IER, 1999).

Investment/wholesale banking is characterised by a general trend of rising skill levels, and rapid growth in investment banking and financial markets has created a need for more people with these skills, and with different skills. Leading-edge firms thus have a need for new knowledge and skill-sets, often team-based, which are not immediately available, either in the firm or the market.

Finco1 and 2 suggested that **skill levels have risen across the board**, for a number of reasons:

- the increasing focus on performance, through the introduction of performance management and business performance measurement systems
- mergers raising skill levels, and poor performers being made redundant
- a rapid rise in mergers and acquisitions and in the size of companies, meaning more complexity and increasingly sophisticated financial advice being needed
- firms employing more professional specialists in marketing, HRM and IT to support and advise the business, and provide a strategic perspective
- increasing customer demands and sophistication
- specialisation across a variety of products/services
- an increased proportion of skilled employees, as automation has reduced the number of lower skilled jobs

- movement towards electronically-based organisations and/or Web-based working
- firms looking for a higher calibre of person and raising entry requirements accordingly
- staff studying for further qualifications
- expecting people to develop as their role changes over time

The rapid rise in the number of 'deals', the increasing size of client companies, and the generally greater level of complexity in situations, problems and issues, mean that skill requirements are now of a different order in market-making, asset management and corporate finance. The introduction of Web-based business will also create significant skill gaps, particularly during the early transitional phases. Skill gaps in all of these areas are significant, since they can detrimentally affect levels of revenue and, with Web-based business, the potential cost savings.

In **Finco 3**, with introduction of the corporate payment system business, back office administrative staff will need to move away from paper documentation and telephone skills to electronic real-time data capture. The FX call centre staff, currently interacting with customers through telephony will need to be re-skilled so they can operate Web help-line technology. To fully maximise the potential of this form of delivery for payment services, new skills are needed in leading-edge e-commerce thinking, involving strategic marketing skills, new product development skills, and channel appreciation and development skills. Because of the fundamental nature of this change, all staff (including management) will need skills to manage and absorb change and deal with ambiguity.

In *retail financial services*, on the other hand, skill gaps involve a complex mix of reconfiguring skills, rising skill levels, skill obsolescence, and cultural change.

The changing nature of the business in branch banking has made **previously key skills obsolescent**. Transaction skills are being replaced by sales skills, basic lending skills have been automated and, with more products being sold over the telephone and other new distribution channels, there have been profound changes in the skill-sets needed. There has been a gradual transition over the past ten years or so, as customer-facing staff have needed to acquire problem-solving skills and an ability to identify possible sales leads. Increasingly, staff are required to develop skills for cross-selling, and, for some, to do so in an increasingly regulated environment. An increased focus on customers requires a **different skill-set**, particularly the 'soft' skills of building and managing relationships, identifying customer needs, and generic skills in problem-solving. Diversification of products/services also means increased flexibility and knowledge to sell a variety of products/services.

As a result, in branch banking, lower-level staff are now expected to undertake the type of work a manager would have been responsible for only ten years ago. However, from another point of view, professional banking skills have been devalued and traditional bankers deskilled:

People have been deskilled, because the specialist knowledge and discretion that were the hallmark of seniors has gone (Finco4).

The banking expertise, once held by professional bankers, now resides in expert systems used by customer-facing staff who may not have banking qualifications, and may be in quite low grades. This applies equally to insurance (Finco6), where know-how resides in the system used by call centre staff. While large numbers of banking/finance/insurance professionals are no longer required, however, those remaining need higher level skills to deal with the non-routine, more novel problems that arise.

As with investment banking, therefore, the level of skills required for branch banking has risen not only because of technological developments, but also with the importance attached to customer service, sophistication of customers, and increased competition raising the required levels of performance. Many of the routine, repetitive tasks have been automated, leaving mastery with the technology and management of information. **Skill levels have risen** in professional functions, such as marketing and customer relationship management. Management skills were regarded as more exacting, with performance management systems, and the need to manage staff with a different profile (i.e. younger, non-technical specialists).

These changes in tasks and skills have also meant a **change in organizational culture**. Staff are expected to develop new attitudes, as they are given more responsibility and driven to take more ownership and become more accountable. Line managers have been on performance coaching courses, which aim to get staff thinking for themselves. The manager is expected to question staff, so they sort out problems for themselves, and this is intended to lead to improvements in both staff and line managers' skills. However, skill gaps still exist here in spite of training, because managers often do not see or accept the need for changing practices.

As a result of these and other changes in *retail financial services*, there exist a series of skill gaps affecting different groups of employee and aspects of skill:

- The move to outward-bound calling in call centres requires a different person profile to that of inward-bound calling. *Call centres* need staff with confidence in talking to customers, an ability to generate sales leads, and good organisational skills (to cope with the paperwork involved). This means developing and recruiting people with particular generic and attitudinal characteristics as part of the sales skill-set.
- *Managers* in customer support centres and business banking often lack in-depth knowledge of sales and the other specialist roles they manage, as a result of their previous training and experience in older ways of working. Hence, they do not always appreciate the skills and aptitudes needed for meeting the changed demands of the business. The full range of skills in these jobs is therefore not always considered when recruiting and developing people, which perpetuates problems and deficiencies.
- *Managers* often lack skills in performance management (setting objectives, reviewing, appraising). Across all firms, gaps are to be found in managers' people management skills, and, often, the poor performance of both managers and their staff is not addressed.
- Changes in cultural and management style, away from a 'command and control' style towards 'empowerment', have still some way to go. Finco5 and 6 have both made significant investments in 'empowerment' initiatives. But changing *the roles of manager and their subordinates* is still in a transitional stage. Finco4 has significantly delayered and devolved managerial responsibility. However, resentment was caused by the way changes were managed, and the lack of incentives for accepting increased responsibility.

- Across banking, finance and insurance, most firms are concerned about skill gaps in those responsible for *driving and managing change* (including confronting poor performance, leadership skills, and coping with ambiguity and stress). Finco6, for example, has recently restructured to include HR, IT and change management under one director, while Finco5 considers change management to be a critical function and has appointed a programme manager to be responsible for this whole area.
- Despite recognising the importance of this area, however, a recent study (Woodward and Hendry, 1997), which investigated skills in managing and coping with change in financial service firms in the City of London, found that many of the changes introduced into companies had not brought about desired improvements in business performance. There was a clear discrepancy between senior managers and employees about the level of support given for change. Senior managers stressed only a limited number of sources of support. Employees emphasised almost entirely things that give them a sense of autonomy and control, while managers emphasised things which they, as managers, controlled. This matters, because how change is led is an integral part of *lower-level staff* being able to make the transition in skills and understanding, to deal with the changing demands of the business environment.
- A variety of skill gaps have occurred in relation to *IT,* as different generations of hardware and software are rolled out. Whereas branch systems would have been upgraded every three years or so in the past, nowadays this upgrading takes place yearly, or more often. As mentioned earlier, firms are seeking to utilise hybrid IT expertise to develop tailored systems to support the business. When skill gaps have occurred this has been addressed by in-house developments (Finco1 and 6), bringing in expertise from locations in other countries (Finco3), hiring contract staff (Finco5), or outsourcing (Finco5). Finco4 has chosen to use agencies to recruit additional staff with Unix skills, and pays top rates to recruits because there is such a high level of competition in the market-place for Unix experts and Unix underpins one of the key operating systems in the firm.
- Skill gaps are to be found across all firms as they seek to change their structures, technology and business processes, to cope with constantly changing external circumstances. Firms address this by employing staff who are more able to cope with change and adapt in flexible ways to changing circumstances. Initiative, self-reliance, independence (but a willingness also to work in teams), less risk aversion, and being proactive are important *generic skills and attitudes* sought in existing staff and new recruits. Significant gaps in these skill requirements are to be expected as, historically, these would not have been encouraged within the culture that used to prevail, particularly in retail banking.

Skill gaps in all of these areas have significant implications for organisational performance. Sales skills, advice-giving, and problem-solving generate increasing proportions of revenues. ICT systems to support these activities play an integral part, and their development and design is key to leveraging people skills. With firms having a general aim to 'do more with less', fewer people are expected to make more sales, or provide more customers with advice to increased levels of efficiency. Cost reduction measures also create additional pressures for staff to be more efficient and effective in their working practices, which has implications for self-management. Finally, managers' skills are critical in supporting staff learning and development, and thereby in reducing skill gaps.

- **What is the extent of skill gaps? How do firms identify their skill gaps?**

Companies varied in the sophistication of approaches used to determine the existence of skill gaps. Some merely produced numbers as part of the strategic planning process; in others, senior managers would ask a project team to undertake an in-depth review of what future skill needs might comprise, and then compare this with the existing skill profile. These approaches naturally lead to different levels of understanding about the extent of skill gaps.

Firms vary also in the extent to which managers are involved in skill gap issues, and whether skill issues are driven by senior management. In Finco1, the CEO took an active interest in skills issues and was pushing for the importance of leadership skills across all businesses. In Finco2, each business unit was treated as a separate entity, and the CEO did not seek to develop a corporate view of skill gaps or push for skill enhancements. However, skill issues were seen as important by each of the Managing Directors in Finco2, since skill gaps could directly affect their performance-related rewards. A discrepancy in perceptions between senior management and lower level staff about the extent of skill gaps was particularly noticeable in Finco4.

Many individuals were aware of skill gaps relating to managing change capabilities, and some firms are particularly aware of the importance of addressing their changing culture:

The greatest problem in the existing workforce is people's lack of flexibility. Many prove hard (i.e. unwilling) to re-deploy and retrain and there is a lot of resentment. Previously, staff have not been asked to show initiative and self-reliance and take responsibility for their own advancement. Managers are not supporting the new culture, as they don't see its relevance. Change is not being handled well (Finco4).

Our main skill gap would be our deficiency in changing our culture. As managers, we need to become more responsive, to be able to learn from what we do, to give feedback more constructively and openly, we need to move away from the control and command culture to a more empowered culture. This will help us become quicker and more responsive to survive in the marketplace. (Finco5)

Finco 5 is addressing the need to balance the operational running of the business with the need to manage change so the organisation becomes more adaptable and responsive. It has recently decided that, whereas before it had a pool of project managers and project support that the business could utilise, now change should be managed by the businesses. Hence, the role of project support has changed to raise the skill levels of those in the business who are expected to manage change. This includes the need for the senior executive to have good project management skills, and or staff to have good team working skills. The focus is on the whole infrastructure of roles and responsibilities around business change projects.

- **How do case firms reduce the impact of skill gaps?**

Skill gaps are prevalent, but are being addressed by firms in an increasingly performance-driven culture. The actions being taken reflect how seriously these are viewed. The strategies to address skill gaps take three forms - upgrading skills, organisational solutions, and strategic responses.

(1) Upgrading skills in technical areas is often best met by closer partnerships between education providers, the FSA, sector associations and institutes, and firms. For example, closer industry and educational partnerships have led to educational programmes to deal with skill deficiencies in analysis and research in insurance, investment and risk management.

Skills to meet some of the challenges in investment banking are best developed by capturing the tacit knowledge generated when staff undertake leading-edge client projects, or deliver innovative financial products based in staff/client interactions and shared knowledge. Knowledge management systems can also contribute to reducing these skill deficiencies. Firms often use consultancy expertise in ICT and expect some transfer of expertise.

Training and development within firms plays an important part in the case of IT staff, who need continual opportunities to upgrade their skills as technological changes are introduced, in developing hybrid skills by broadening experience through on-the-job training and lateral career moves.

(2) Organisational solutions indirectly address skill gaps. For example:

- *Delayering* attempts to devolve responsibility further down the organisation (Finco4, 5 and 6).
- *Recruiting new senior people* (some from outside the sector) introduces new ideas and change practice (Finco5 and 6).
- *Team working* improves communications and removes functional silos (Finco5 and 6).
- *Automation*, and processes which involve customers taking over some of the tasks that were once the preserve of staff, avoids or reduces skill gaps (Finco1).

(3) Strategic responses. Finally, firms may adjust to skill gaps by actions that circumvent the problem. Sometimes, this is simply a form of avoidance and pushing responsibility elsewhere; in other cases, it involves specialisation within the market.

- Senior management may decide it is no longer economical to hold or develop particular skills in-house, and so *outsource non-core functions* (Finco1, 3 and 6). This generally occurs where other firms can undertake these activities reliably and more cost-effectively.
- Additional skills have often been sought through *mergers, acquisitions, joint alliances and partnerships* (Finco1, 2 and 3) - especially when skills will take too long to develop internally.
- Where product/service markets have not been delivering the required returns because skills and other resources have not been particularly strong, firms have chosen to *move out of these business areas* (Finco4 and 5).
- In *choosing to concentrate on niche markets* (Finco3 and 6), skill gaps can be reduced more easily because increased resources are available.
- Some firms have moved parts of the business to *locations abroad*, where skills are not in short supply (Finco3), or *brought in skills* from non-UK sites (Finco1, 3 and 7).

3.6 Skill Deficiencies: An Assessment

A skill deficiency can be described as the sum of skill shortages and skill gaps (IER, 1999), and can be seen in terms of:

i. dynamic excess demand for a given set of skills and experiences which is increasing faster than supply

ii. temporary imbalances

iii. cyclical imbalances

iv. supply falling faster than demand

v. marked changes in qualitative aspects of demand, where the nature of skills and experiences required in a job have changed, and so affect the supply of people competent to fill these posts

Banking, finance and insurance cases have been subject to all of these:

- There has been dynamic excess demand for quantitative analysts in Finco1, which has identified and addressed this recently by establishing courses and qualifications
- Temporary imbalances can occur when business is seasonal (as with mortgage products). Temporary imbalances in investment banking have occurred during the last year, because of an exceptionally successful economic situation (Finco2 and 3).
- Cyclical imbalances occur when markets respond to changing economic conditions, and large numbers of staff are recruited or released when specific markets experience downswings.
- Supply falling faster than demand can occur in local markets, where increasing numbers of financial service firms establish call centre activity, such as in Bristol (Finco4 and 6).
- Marked changes have taken place in the nature of skills and attitudes required of staff in branches, and this has been addressed through branch closures, recruiting different people, or offering retraining to existing staff willing to make the change (Finco4, 5 and 6).

Responses to skill deficiencies can have obvious resource implications. For firms to make comprehensive and co-ordinated responses, the first step needs to be for senior management to appreciate the importance of skill issues:

I don't think the rapid pace of technological and market development will stop us responding to skill deficiencies now and in the future. It makes skill deficiency, and the importance of skill development, that much more important. In a way, it should help us, because it brings the problem to the surface at senior management level (Finco5).

As this study has shown, senior managers across both sub-sectors continue to face considerable pressures for change from a number of sources. Much of the earlier discussion highlights the importance of strategic management skills, and in at least two cases there was evidence of problems in this area. In both examples (Finco5 and 6), firms have been placed at a considerable disadvantage because their business has not changed sufficiently quickly in terms of technology and markets, through top managers not appreciating the significance of approaching developments. While these are now being addressed in Finco5, Finco6 is still at risk.

In the London Insurance Market, the significance of technology is also not fully appreciated at a strategic level, partly because firms do not have people already in the business who understand these things. In these examples, past skill gaps contribute to present ones. In contrast, the three firms making successful mergers and acquisitions (Finco1, 2 and 4) would seem to have special strategic skills in this area. The conclusion from this is that latent (or unrecognised) skill gaps are largely a product of failures in strategic management, a point we will now develop in relation to each firm.

3.7 Perceived and Latent Skill Gaps in Successful and Unsuccessful Firms

Finco1 has a history of mergers and acquisitions which have created a company that competes worldwide in both retail and wholesale financial markets. This has been designed to achieve breadth, scale and global reach. Subsequent consolidation has led to staff surpluses and the improvement of quality by selective retention, although growth has also placed strain on areas where skills are in short supply. Finco 1 is not a British company and strategic decision-making is located outside the UK. Britain only provides a portion of the services available worldwide, and the company has no retail presence in the UK. Nevertheless, the UK is by far the most significant element in its European operations, and is the home to global hubs for certain services. The availability of appropriate skilled labour at the right price is critical to its decision to locate some activities in the UK. In other instances, where activities are closely tied to the location of related financial services (as with client-oriented work), the company has little option but to locate services in a major financial centre such as London and to compete for scarce resources, such as analysts. In the first example, cost and scarcity are a barrier to growth in the UK, but not a barrier to the firm's growth; in the second they are a barrier to growth per se. This has led Finco1 to review its personnel resources and policies, as well as its local management skills. Senior management appear to be increasingly aware of these issues locally

Finco2 faces some of the same challenges. While it appears to possess strong strategic management skills, there may be hidden problems. The Group Chief Executive identifies business gaps, and these are filled through acquisitions and by creating new business units. Although the company claims to have few skill or knowledge gaps, it does tend to operate sub-optimally for some time before a successful acquisition is made in furtherance of the strategic plan. Growth is also impacted by the time taken to bring in niche teams, which are the engines of its growth. Other 'capacity gaps' occur when business levels are rising, and these also affect performance. Steady growth has put a strain on the businesses; new products have required new skills and staff; and there is a need for IT expertise in developing systems for private banking. These skill requirements have not been recognised by group management. Similarly, although the philosophy of the firm is to keep IT simple and unintegrated, when this issue was probed, it was agreed that bespoke programming was a growing skill need. Although their culture has served them well, and is in sharp contrast to the 'hire and fire' attitude of many investment banks, top management also needs to acknowledge the demands and pressures created by absorbing increasing numbers of staff. People management skills are becoming more important as the firm grows numerically, and this has yet to be appreciated by top management.

Since firms are strongly driven by financial considerations and the need to deliver shareholder value in a competitive market place (as discussed in Section 2.3), it is unlikely that global firms could survive if they had skill deficiencies that led to less efficient operations and inferior product strategies. **Finco3** has clearly recognised that the move to electronic data-capture will require staff to increase their computing skills and information management skills, and develop flexible attitudes to change. Managers will also need to confront issues of poor performance. Existing skill deficiencies have slowed product development, and difficulties in recruiting senior relationship managers have slowed the development of the FX outsourcing. Attitudes to change, however, are recognised as the key, since they slow the speed of response. However, they have a very pragmatic approach to skill deficiencies. They will adopt whatever tactics are necessary to resolve any skill problems the business strategy creates. Thus, they have outsourced IT hardware maintenance; relocated call centres; retrained and developed staff; brought in change management consultants; paid a premium to recruit key skills (relationship managers); and bought in expertise from sites abroad. A global company with a global mindset like this does not pursue one option only to deal with skill gaps.

While there is limited evidence of significant under-performance resulting from skill deficiencies in the investment/wholesale cases, there does seem to be a real risk to future performance in retail financial services, because of cost reduction measures that have not been taken within a wider strategic framework.

This has particular relevance for **Finco4**, where a successful merger has provided shareholders with very good results and higher than average profitability for some years. However, since these were largely derived from cost-cutting exercises and shedding staff, the process is now slowing down. When optimal staff levels are achieved, profit will even out, and bank profitability will depend on the success of its operations. Increased competitiveness in the marketplace means people have to generate more profit, and that profit comes from sales. Hence, every member in the retail banking staff with a customer-facing role must generate sales. However, shortage of regulated sellers is severely limiting the banks potential in the market. This shortage is related to continuing cost reduction measures.

Senior managers agree that the market is customer-driven and that, since all competitors offer similar products at similar prices, significant advantage must derive from the manner in which they are marketed and sold, and the methods of delivery to the customer. While heavy emphasis is placed on raising customer awareness and the timely production of competitive products to meet perceived needs, the requirement for a well-trained and competent workforce to service those needs is a secondary consideration for senior management. The lack of sales staff, of people willing to be trained, and a lack of training itself may be the greatest threat to the bank's profitability. It is clear that line managers believe these pressures cannot be sustained, but senior management seem unaware of day-to-day problems that will not go away.

Evidence of a more positive interaction between recruitment strategy and skill enhancement was found in **Finco5**. Here, poor past performance, arising from the deficiencies of senior staff, has led to the recruitment of people with new skills and perspectives from other industries. Replacements have been recruited at senior management levels to address HR, financial and operational issues. At the same time, a new post in marketing has been created in recognition of the importance of strategic marketing skills. Re-organisation and redundancy has improved back-room operating efficiency; significant investments have been made in technology to provide competitive information; and a large number of new managers have been recruited into the branch network to help drive the cultural changes. New people, with knowledge of the business opportunities provided by new distribution channels, have also been recruited. Management information systems now provide information forecasting, which allows them to identify costs and compare cost/income ratios at branch level. This has affected line managers, who have become more skilled in managing their budget and in being accountable for it. In product development, people with hybrid skills and cross-functional teams have developed skills in using financial modelling, in forecasting, planning, and in linking with the treasury function.

Also in Finco5, technology is replacing many basic skills, and will continue to do so. Multi-skilling is considered essential for customer-facing roles, and existing staff are being retrained and others recruited. The company is aware of the need to remove functional silos and broaden business experience, and is putting teams and structures in place to support this. Thus, an essential skills-set is seen to be in-depth business knowledge and lateral thinking, to generate ideas for new ways of working and improving performance.

In this case, turnaround in performance arises in part from the recruitment of new skills into the top of the organisation. As one of the new managers commented:

"Not having been sufficiently forward and outward looking suddenly highlighted the weakness of our thinking for the past three or four years" (Finco5).

In contrast, the current strategy of **Finco6** appears unsustainable. Call centre activity will change, as less volume will be driven by colleagues in the retail bank, and this means there is a need to find new delivery channels and alternative markets. As an intermediary, Finco6 needs to decide whether it will remain an in-bank call centre. Since intermediaries are particularly threatened by Internet growth, strategic choice is critical here. If outward-bound calling is chosen, staff will need to recognise the priority of different callers and supply bespoke services, which has significant implications for investments in new technology. Skill implications will include team leaders' ability to drive change, and their ability to understand and manage new markets and new market information, particularly the need to identify trends to a much greater depth of complexity than at present. Agents will also need to be recruited, as outward-bound calling requires a different profile.

In this case, the problem is coping with rapid change in the nature of the market and making timely investment decisions in technology. Management are constrained from doing so, however, by poor past performance, and are thus trapped in something of a vicious circle. As one manager observed:

There are fundamental changes occurring in where we will get future business, and this is throwing up a lot of questions about how we are going to meet those challenges. We can't dwell on those forever, because we will have lost our market position and momentum. The worst thing you can have is a workforce that is under-utilised. Management becomes difficult, and good staff leave. Then, when you do find your feet, the market picks up, and you have the opportunity to generate business, you find you don't have the skills around to support it.

To conclude, each case has certain unique features. The common factor, however, in the examples where performance has been sub-optimal (Finco6), or where highly successful performance could be damaged in future (Finco2 and 4), is senior management's strategic thinking. In Finco2, it is a reluctance to accept the importance of IT back-up; in Finco4, it is a focus on containing costs at the expense of developing regulated sales staff; in Finco6, it is hesitancy in responding to changing market conditions and delaying technology investment decisions. While these all have specific implications for skills, the inference is that it is deficiencies in strategic management which affect skills in the business, rather than deficiencies in basic skills constraining the strategy. In other words, if there is a problem of skill gaps in investment/wholesale banking and in retail financial services, it lies with a skill deficiency on the part of senior management, a consequence of which is that there may be skill deficiencies at various points in the organisation.

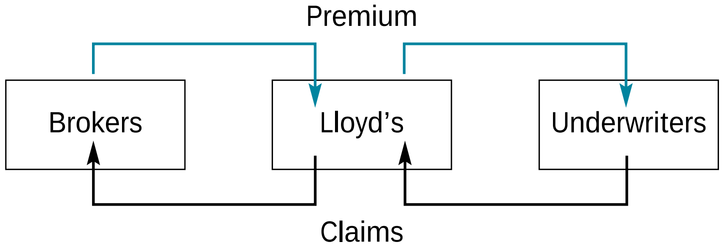
PART C: LONDON INSURANCE MARKET

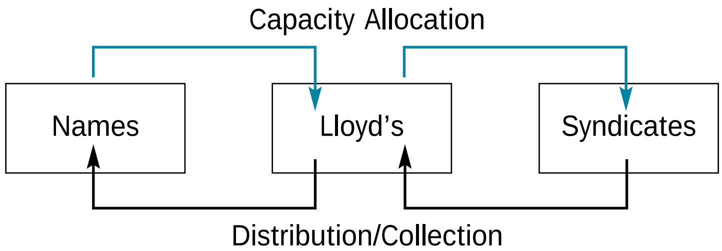
4. CONTEXT AND CASES

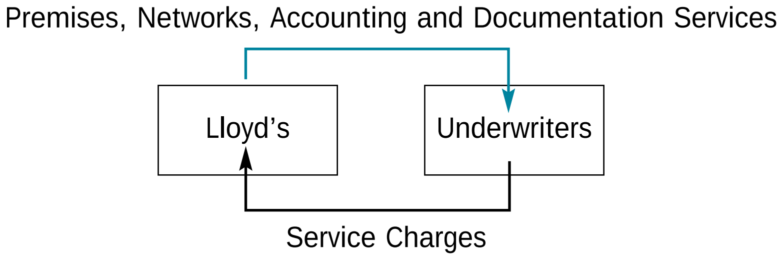
4.1 Characteristics of the Market

The insurance market in London is a business district that has grown up around Lloyd's of London. Market activities provide an important source of premium income, accounting for over a third of the total non-life and reinsurance business written by the UK insurance industry, and a third of the world market for Marine, Aviation and Transport (MAT) business. While employing only around 50,000 people, insurance and reinsurance activities generate gross premiums of around £14.5 billion (ABI, 1999).

Lloyd's is a self-regulating market place organised by the Corporation of Lloyd's and supervised by the Financial Services Authority. It occupies a key position in a series of interconnecting value chains that can be outlined thus:







4.2 Details of the cases

These value chains show that the market has a number of distinct, but linked, entities. Lloyd's Brokers offer risk transfer activities to domestic and international clients through their interactions with Underwriters. Some underwriters operate in Lloyd's syndicates, which are managed by a Managing Agent; others are members of the 'Fringe' (described below). 'Names' provide capital to syndicates through the services of Names Agents (for individual Names) and corporate financial advisers (for corporate Names). The Corporation of Lloyd's Members Services Unit provides a range of services to different players. Each entity has its own generic product market strategy and its own distinct skill set.

Five cases (Finco7 to Finco11) were chosen to represent the main players in the market. Fincos7 and 9 include an insurance company member of the International Underwriting Association (IUA), and Lloyd's underwriters. Finco8 represents Lloyd's Brokers. Finco10 focuses on the capital capacity market, where capital to support the underwriting of insurance and reinsurance is provided by 'Names' (individual investors and corporate members). Finco11 is the Members Service Unit of the Corporation of Lloyd's.

Four of these are composite cases because, while Lloyd's and the International Underwriting Association supported the project, there was only limited co-operation from individual companies. The case reports for Finco8 to Finco11 therefore cover interviews with representatives of HR, management and operational employees from a selection of firms in each part of the London Insurance Market. In the text, firms are referred to in capitals and individuals in lower case (for example, Broker firms and individual brokers).

5. BUSINESS STRATEGIES

5.1 Sector Drivers for Change in the Market and Their Effects

The London Insurance Market has seen major changes over recent years, and problems experienced by the Lloyds market have been instrumental in driving these changes. In the 1980s and early 1990s, a number of trends caused Lloyd's of London to suffer catastrophic losses. These included an increasing recognition of the likely cost of liabilities arising from policies underwritten over several decades in the USA, unexpected levels of disastrous events, and a large increase in Names, which helped to fuel the growing tendency for the inter-change of business, leading to the 'LMX spiral'. (London Market Excess (LMX) is the reinsurance market, where syndicates provide reinsurance for each other. The spiral was created because those seeking reinsurance were also accepting reinsurance business from other market participants). There was, in addition, a magnification of losses because of coincidence with a low point in the premium rate cycle.

A business plan for Lloyd's, developed in response to the crisis, has been undergoing implementation over the past five years and is a key driver for change in the sector. This plan encompasses five distinct elements, namely to:

- *reduce costs* (e.g. automate and streamline business processes, restructure the members' agency system)
- *manage problems* arising from historical factors (ring fence these claims)
- *raise new capital* (e.g. manage the aggregate market capacity centrally; admit incorporated capital under different conditions)
- *strengthen regulation* (improve reporting, improve standards of professionalism)
- *strengthen business development.*

The relative pre-eminence of Lloyd's has declined as a result of the crisis, and other insurance companies have acquired the skills and aptitude to accept the unusual risks with which Lloyd's has always been associated. A 'fringe' of companies has set up offices around Lloyd's, staffed and equipped to accept similar risks. The 'Fringe' numbers several hundred companies and now is as significant as Lloyd's, handling 52% of gross premium, compared with Lloyd's 39%.

Fringe companies have, in the past, generally restricted the scope for doing business to Lloyd's Brokers, but this has been for accounting reasons rather than for the business standards associated with Lloyd's Brokers. Recently, Fringe companies have outsourced most of their accounting function to the International Underwriting Association (IUA). As any broker with an IUA account can place business with a fringe company, there is no need to become accredited at Lloyd's, as must the Lloyd's Broker. This has impacted the profitability of the Lloyd's Broker. But, at the same time, improved communications have enabled Lloyd's Brokers to access insurers in ways that used simply to be impractical. This has reduced the significance of Lloyd's and the rest of the London market to the Lloyd's Broking community and, similarly, reduced the significance of the accreditation as Lloyd's Brokers, since any broker with efficient communications can access the same markets.

The London Insurance Market has embraced IT with enthusiasm, but the fragmented nature of the market has resulted in its adoption in a piecemeal fashion and it has not been used as a strategic driver except in individual organisations. The efforts of the market to impose an EDI network have been very successful in the area of financial transactions, and all transactions have been handled electronically since 1996. However, information transactions have been much less successful and have failed to make a significant impact on trading practice and the strategic use of information.

The high proportion of US business underwritten in the London market makes London vulnerable to variations in underwriting conditions in the US. London insurers have to match US insurers to the latter, weaken their underwriting terms, or expect a reduction in their premium income from the US, income that has to be made up from other sources. When the US market is buoyant there is a steady flow of relatively predictable income to London. But when it turns down, London underwriters need to broaden the range of business they are prepared to accept, and hence require a wider skill set to do so effectively.

Appendix 4 describes detailed changes affecting the market position of Names' Agents and the creation of Lloyd's Members Services Unit (MSU) to support this area of activity.

The nineties saw a dramatic change in the fortunes of the London Insurance Market. The response from the market has been to broaden its operations and horizons to include risk management and other financial products that are not related directly to its traditional risk transfer function.

Lloyd's itself has extended its role from facilities management and transaction management to include active regulation, strategic direction for the market, and financial management for the Names. It has come through the difficult period leading up to the publication of the 'Reconstruction and Renewal' document, and has succeeded in re-establishing its influence in the London market, even if London has lost its leadership in the global insurance market.

5.2 Product-Market Strategy Responses

(a) Lloyd's Broker firms product market strategy responses

Lloyd's Broker firms (Finco 8) share a common product strategy, within which there are areas of greater or lesser development. The main strategy has been to offer Risk transfer facilities to domestic and international clients. This can be divided between insurance and reinsurance, and between the various classes offered by the insurers. Lloyd's offers Marine, Aviation, Non-marine, Motor and Short term Life insurance. Other classes of Risk Transfer that are offered by insurers outside Lloyd's are Credit Risks and Long Term Life. Each market can be described as representing a generic product line, within which there is scope for separate new and existing products to be developed. Markets are largely self contained and use separate, but parallel, skill sets to maintain and develop products. There is no need for the staff of a Broker specialising in Marine business ever to meet staff from Brokers or Insurers offering Motor insurance, although the skill-sets are very similar.

Insurance products and services are seen as the product strategy and, while brokers identified their output market in the form of their clients, none commented on their input market (the insurers). Yet, a significant element of their product strategy is the information they provide to insurers, and brokers know very well that the better the quality of information they can provide, the better the quality of output, in the form of terms and price, for their clients. The utilisation of IT should also be seen as a significant differentiating factor in the product strategy, yet brokers did not identify this.

Some Lloyd's Brokers, especially the larger ones, have extended their strategies to include Risk Management, as a substitute for Risk Transfer. The less sophisticated Brokers have viewed this with some suspicion, as they have traditionally relied on contingent commission for their remuneration, and they have been slow to understand that they can offer their services as consultants and bill their clients for time, rather than rely on results.

There is a sense in the Broking sector that the role of the Broker is under threat from a number of directions, and they are seeking to find ways in which they add demonstrable value to transactions, rather than just passing risk between parties that could easily carry out the transaction for themselves. The principal responses - of niche specialisation and conversion to risk management consultancy - are both sustainable, but both carry skill implications that cannot easily be met from the market.

(b) Underwriters' product-market strategy responses

The main product trends in the market for underwriting (Finco7 and 9) have been threefold - (i) a tendency to accept higher proportions of risks presented to them; (ii) a drive by Lloyd's syndicates to set up direct writing facilities; and (iii) the introduction of new classes.

Lloyd's syndicates are very sizeable risk transfer operations, numbering around 150, and comparable in size and capacity with all but the largest insurance companies. There has been a tradition in Lloyd's of sharing risks - brokers would allow a number of syndicates to subscribe, and syndicates would not usually accept 100% of any risk unless it was very small, but this is changing. As syndicates have grown, and their internal reinsurance arrangements have become more sophisticated, they have begun accepting an increasing percentage of risk. Concurrent with the trend towards larger lines, Lloyd's underwriters have also come to consider the insured, the client, to be their contact, not just the Lloyd's Broker's. Each Lloyd's syndicate has a Managing Agent that may manage several syndicates at a time. Recently, Managing Agents have set up direct trading operations, to bypass the services of Lloyd's Brokers and claim the client relationship for themselves

The product strategy for the Fringe companies is much more straightforward. Their offices in London are set up specifically to exploit the efficiency of the Lloyd's Brokers in channelling risk transfer business to the London market. Those with operations based in the UK usually already have direct writing facilities. Those set up by Overseas' companies are not permitted by the DTI to set up further offices without changing their licence to trade. Any that did choose to set up direct writing offices would face exactly the same problems and issues as Lloyd's Managing Agents.

The commonest strategic decision to be made by Underwriters is whether to enter a new class of insurance. In one case, an agency had decided to enter a new class, namely to start writing Aviation insurance. They set out to recruit a specific individual, who they had identified as being technically suitable and personally acceptable to the existing members of the team. The individual was known to be looking for a new job, so it was not too difficult to attract him and his deputy. In this case it was not clear whether the decision to enter a new class preceded the knowledge that the skill resources could be recruited to do so.

The strategies of insurers have been forced upon them by circumstances. Larger acceptances are necessary to attract brokers, who are, in turn, under pressure to complete business to strict deadlines and in the most economic way possible. This has a hidden skill implication in that the co-insurance principal had an in-built peer review mechanism - if the terms set were uneconomic then the broker would not be able to cover the risk. Larger acceptances require greater skill to compensate for the lack of peer review.

(c) Names' Agents and Corporate financial advisers' product-market strategy responses

The market realignment has forced a change in the product strategy of Names' Agents and has allowed the emergence of a new strategy by corporate financial advisers. The providers of capital capacity do not form part of the insurance supply chain, as they are a part of the financial supply chain that supports Lloyd's in its role as financial institution, rather than insurance institution. Its products are financial information and access to the closed financial market of Lloyd's. The latter used to be the principle product and its importance in the supply chain overshadowed the value of any information provided. The position is now reversed, as corporate members are able to approach syndicates directly. The premium service is now the provision of information and Names' Agents are ill equipped to provide it, although they are well aware of its importance.

The current strategy of the Names' Agents is consolidation between companies and acquisition of resources from rival companies by recruiting business. The risk of this strategy is managed by remunerating the new staff on commission and keeping them on probation until their business is transferred. The intention is to build up the financial resources to develop the new service strategy. It is questionable whether this strategy is viable in a market that is contracting at a rate of 30% per annum.

The corporate advisers have a much easier strategic choice as they have the resources to provide detailed analysis and to develop new financial products already in house. They are also in a strong position because their product focus is information orientated and thus supports the new market demand. They also have as their main client base, the part of the capacity provision that is expanding. Their resource constraint is the fact that their product market is too new for a resource market to have developed, so they do not have the benefit of working in a business district.

There is no perceived need to change the strategy for the Lloyd's capacity support product line. It is developing in line with the market and seems to be very viable. The main threat is the entry of new players into the market. The strategic position for the existing players is to exploit their established position and provable track record.

(d) Corporation of Lloyd's Members Services Unit product-market strategy responses

Lloyd's has seen a steady concentration and centralisation of function. Its original function was to provide the premises and associated services, together with the information, demanded by the marine underwriters. It also had a regulatory function that was somewhat cursory and cosy. As transactions increased in volume and the duplication of effort began to make the functioning of the market inefficient, Lloyd's assumed the role of clearing house for all the insurance transactions in the market.

This set a precedent that has guided further centralisation and has resulted in an increasing standardisation in the functions of the market. The driving factor has been the control of costs.

Change in the Members Services Unit is driven by market dynamics. Its strategy is to be able to react flexibly to market demands. At the moment the trend of demand is down, as the number of Names falls. The strategy of flexibility has taken the form of increasing use of IT. Information demands can be met much more easily now by using a web based browser to create a virtual intranet. This has reduced the demand for people to service the requirements of Names and their agents in line with the absolute reduction in demand cause by falling numbers of Names. The latest stage in the centralisation of functions has been the take over of the management and distribution of members' funds. This completes the transformation of the financial aspect of Lloyd's from a property management organisation to a fully functional financial institution.

The main threat to the MSU's strategy lies in the lack of direct competition for the market services they provide. This disguises the fact that there is plenty of indirect competition and substitution for their financial services. The strategy of responding to market dynamics puts them at the mercy of market forces that are not part of the main financial market. This suggest that the implementation of the strategy is not self sustaining and will need a lot maintenance if it is to be successful

5.3 Production Processes and Knowledge Development

(a) Lloyd's Brokers

Broking firms divide their staff into brokers who negotiate with insurers, and technical staff who provide the back up. There are also support staff, such as IT and secretarial staff, but management in Brokers is generally recruited from the broking staff and there are not many specialised managers, even in large companies.

The core differentiating skill set of a broker is his/her knowledge of the insurers who will offer terms in his/her speciality. A generalist broker will know more people than a specialist. When a Broker wishes to enter a new class of business, frequently the first step is to find a broker or a team of brokers who know the insurers in the market. The next step may be to acquire the technical knowledge to support the brokers. Sometimes, the knowledge already exists within the firm, if there is a broker who already has knowledge of the market, e.g. where an Aviation Broker takes a strategic decision to handle Personal Accident Insurance. Aviation insurers often underwrite Personal Accident insurance as a sideline so the broker can use existing contacts to develop the new strategy. The insurers will direct the broker to other insurers who accept the new class, knowing that this will improve the relationship. Insurers with technical resources of their own will also provide technical assistance if the Broker has limited technical resources to support the new class. The flow of knowledge from insurers to brokers is a key element in the development of skills, especially among brokers.

(b) Lloyd's Underwriters

Lloyd's syndicates divide their operations physically between their Box, which is their desk in Lloyd's, and their offices, which are usually outside Lloyd's. The floor rental in the Underwriting Room itself is so expensive (currently £297 per square foot) that considerable ingenuity is exercised to minimise the footprint of a Box and maximise its utilisation. To control costs, only the underwriting staff are accommodated at the Box, all back-up staff work in their offices, which have to be reasonably near Lloyd's, but can be much cheaper to rent. There are efficient data links between Lloyd's and offices and a telephone system that allows unlimited communication between Agents, Boxes and Brokers for fixed fees, irrespective of utilisation. All syndicates are networked and have the bulk of their records held electronically, thus reducing storage problems.

(c) Names' Agents

Names' Agents are small organisations although the average size has increased as companies have merged. Even the largest employs only 120 people. They do not distinguish between managerial and operational (sales) functions and all managers have to 'carry their weight' by developing and maintaining their own business portfolio. Agents used to have three critical functions: gathering and disseminating information about Lloyd's syndicates to their clients; identifying suitable syndicates for their clients and providing access to them; and administering the financial affairs of their clients, which included administering funds and distributing pay-outs. But, since the Members Services Unit now handles the latter function, Agents need to gather information, undertake analysis, and provide appropriate access.

(d) Members Services Unit

The Corporation of Lloyd's physically divides its resources between London and Chatham. The efficient telephone and IT networks make it hard for users to tell where the London activities end and the Chatham ones begin but, as a general rule, the direct market support and management activities are based in London and the back up and processing facilities are located in Chatham. Skills within the MSU in London are deployed in teams, with a certain amount of cross functionality. Custody management teams may have to cover some of the auction function. Distribution activities are seasonal and may be covered by parts of other teams. The common factor is flow of information, which is facilitated by IT. A major day-to-day activity is handling concerns and enquiries from Names over the telephone and by mail, and a recently upgraded IT system is expected to make this process more efficient. Separation of operation between London head offices and infrastructure offices outside London is common practice and requires that the functional division between the offices is clear and stable. Problems have arisen when functions are transferred between offices or if key people become disenchanted with the new arrangements. Lloyd's has overcome these types of problem by the use of IT to de-skill the Chatham operation, enabling recruitment to be wider and less selective. Lloyd's has also restructured its operations into core and non-core with the latter being managed by subsidiary companies.

6. SKILL NEEDS AND DEFICIENCIES

6.1 Skill Needs

Market changes and responses have created new skill needs, and changed existing skill-sets. These are detailed below and further discussed in section 6.4.

(a) Lloyd's Brokers

Offering risk management services, in addition to providing risk transfer facilities, means that Brokers will not only need the skills to place business with Underwriters, but will also need consulting skills. These encompass management and technical skills, to identify client's business risks, and generic skills, including communication skills, to advise clients. Brokers, moving into a consultancy-based product strategy, will need to develop their own skill-sets, as these are not available in this market.

Brokers traditionally compete on the terms and price of products/services they offer, and both of these are determined by the quality of information they are able to provide to insurers. This is underpinned by their ability to effectively interact with clients, based on high level 'people skills' (a mix of generic skills and personal qualities), together with technical skills. However, the trend for underwriters to accept an increasing percentage of risk has reduced for brokers the workload involved in the placing of each risk. Also, as Brokers are attracted to underwriters who can swallow the whole of a risk, the increased skill on the part of the insurer has led to a reduction of skill on the part of brokers in their interactions with insurers.

(b) Underwriters

As Lloyd's syndicates are accepting an increasing percentage of risk, the product structure is changing. Although the same skill-set is needed regardless of percentage of risk, it has necessitated a change in the reinsurance buying skill-set, as larger lines require the backing of more reinsurance capacity.

Underwriter's ability to accept large proportions of risk has reduced the requirement for a ''following market' (when the lead underwriter who set the terms only accepted a small proportion of the risk, and other underwriters who were prepared to accept proportions covering the outstanding risk on the set terms were found by the broker). Hence, the peer review that was built into the placing procedure has disappeared, and much less rigour is needed in the setting of terms.

With Managing Agents of Lloyd's syndicates setting up direct trading operations to bypass the services of Lloyd's Brokers, the skill-set of Managing Agents has changed dramatically. They need skills in accounting, documentation and marketing that, previously, were the responsibility of Brokers. Additionally, strong and demonstrable management skills have been forced upon Managing Agents by the demands of the compliance procedures instituted by Lloyd's, and by the expectations of the corporate capital providers. The latter investigate the capabilities and consistency of the syndicate to which they are proposing to subscribe, including management capabilities as well as underwriting expertise.

Entering a new class of insurance requires a number of skills. These include being able to assess, rate and accept profitable risks; design and buy adequate reinsurance to make it attractive to brokers; and disseminate the information that the insurer is accepting the type of risk amongst the brokers who form the potential market. This last point is more complicated than it sounds, as brokers cannot be relied upon to disseminate this information amongst themselves. Brokers regard their knowledge of which underwriter writes for specific classes as sensitive information.

The skill-set at high levels of underwriting complexity includes underwriting expertise, technical expertise, reinsurance programme design, market-liaison skills to attract brokers, and reputation. It also includes team leadership, as underwriters operate most effectively as part of a team, and not all the skills in this skill-set need to be contained in one person.

(c) Names Agents and Corporate Financial Advisers

The skills required by Names Agents for the gathering and analysis of information have changed dramatically. When skills requirements were fairly low, it was possible for sales staff to handle the analysis themselves, but Agents are now trying to change the way they deploy their skills and build a distinct specialist analysis capability, as their clients become more demanding. Financial institutions distinguish between the skills of the analyst and the sales person. Those working in financial institutions believe that it is difficult to find an analyst who can also be a good sales person. Hence the roles are usually separate, and problems can arise where team-working skills are lacking. That a good sales person needs the support of a good analyst applies to Names Agents, quite as much as to financial institutions. The key difference is that the latter have the financial resources to organise their skills in this way, while Names' Agents do not.

(d) Members Services Unit

The MSU now needs banking and finance skills to resource its newly acquired tasks of share management, custody and financial service, while it continues to require clerical skills to support its documentation services.

6.2 Capacity to Meet Skill Needs

Some interviewees were now well aware of the importance of skills and the existence of skill gaps, although with existing practice it is unlikely that skill resources are considered simultaneously with planning business strategies. There is a tendency to rely on the market as a source of skills. This is a valid strategy, provided skill requirements remain stable. If they change, as they are likely to do with the emergence of electronic trading, the market may not be able to provide them and HR processes are not in place to help meet the changing requirements. Additionally, the strategic use of HR is still a rather new concept to Lloyd's organisations.

In Lloyd's Brokers, Managing Agents, and Names' Agents, HR is the responsibility of the line manager, with HR departments, if they exist, holding a very subordinate, supporting role. Most firms, therefore, include HR functions within other management roles such as Compliance Officer or Company Secretary. Only the large corporate financial institutions and Lloyd's itself have dedicated HR support functions. They delegate operational HR responsibility to line managers who have responsibility for the implementation of business strategy. In Lloyd's, particularly, the concept of management as a strategic driver is taken very seriously. In addition, the training functions in Lloyds and the IUA provide centralised training services for the market, because so few Managing Agents or fringe companies have these HR professional skills.

An HR policy for recruitment of Lloyd's brokers was generally considered unnecessary. It was felt that skill needs could easily be satisfied by recruitment. There is very little training past the induction phase, and brokers are expected to learn 'on the job' through their contact with insurers. Similarly, the ease of access to an abundant, albeit temporary, supply of technical insurance skills for Lloyds Brokers through the market means that internal development of skills is not considered a priority, although most companies consider on-going, on-the-job learning to be a fact of life. The abundance of technical skills obscures the fact that other important skill-sets, such as IT use and management skills, are not well understood or valued and, hence, are not being adequately developed. In Lloyd's Underwriters, trainees and junior staff are recruited from school, often on the basis of personal knowledge. In some Lloyd's Underwriters, families of two or three generations are represented in the market. This may help to sustain traditional skills, but cannot be expected to enhance innovation.

Lloyd's Members Services Unit does not have a formal method of identifying skill needs. In common with the rest of the insurance market, the Corporation relies on its managers being sufficiently aware of the strategy, and sufficiently close to the front-line, to be aware of both the need for skills and their availability. This puts a considerable burden on managers who are sometimes deficient in skill themselves.

Lloyd's, however, as a large and rather bureaucratic organisation, has its own training programme, designed for graduates, which is intended to produce high-fliers. Trainees move around the Corporation and often spend time on secondment to Brokers and syndicates. This programme has suffered from the voracious appetite of Brokers for these trainees, and trainees on secondment have often not returned. This stems from the Brokers' and insurers' preference to recruit rather than train. The recently introduced Lloyd's Training Bylaw now obliges Names' Agents to designate a training officer (usually one of the Directors who, however, is himself unlikely to have a background in training).

The overall position of the London Market is that managers are becoming aware of the need to develop skills on a strategic basis and in a systematic way. Lloyd's has been instrumental in driving this change, but the acceptance of skills as a necessary part of strategy implementation is not consistent and has probably not been internalised. There was some scepticism as to the long-term change in attitudes towards skills and training.

The smaller companies are vulnerable to the challenges posed by skill shortages, especially the smaller Brokers where the influence of Lloyd's is weak and there is no dedicated HR department. The fundamental weakness is the lack of managerial skills that could identify and rectify the lack of skills in a wider context.

6.3 External Recruitment Difficulties

There were few recruitment difficulties mentioned by players in the London Insurance Market, generally because mergers, acquisitions, and other structural changes have created a large, albeit temporary, pool of available skills. Those that were mentioned are summarised in Table 3.

Table 3: Recruitment Difficulties in the London Insurance Market

Skills	Lloyd's Brokers	Underwriting Lloyd's syndicates/ Managing Agents and ILU members	Capital Capacity Names and Financial Insts	Members Services Unit
Management and leadership skills	*	*		
Business 'getters'	*			
High level underwriting		*		
Financial and statistical analysis			* *	
Technicians/ clerical skills	*			
Clerical processing				*

- **Management and Leadership Skills**

Managing Agents have been forced to confront their shortage of management skills by recruiting specialist managers, often looking outside the insurance industry for expertise.

Brokers also look to recruit from outside the market, but the smaller Brokers have to confront issues of control, where ownership is with founders, who are on the point of retirement. They need to give way to new blood with greater managerial expertise than themselves.

- **Business getters**

The recruitment of 'business getters' is difficult because good ones are tied to their companies with financial incentives. It takes a long time (an estimated 5-8 years), to develop an effective 'business getter'. They have a rarity value, being in constant demand and able to demand high remuneration. It is not unusual for a Broker to recruit an entire team consisting of business getter, support brokers and technical staff. This may be prompted by a desire to enter a new class of business or to replace a team that has been poached by another Broker.

- **High level underwriting skills**

Underwriters' specialist skills are in abundant supply in the market, but there are problems in finding the very high level skills that may take an individual 10-15 years to acquire. Again, it is quite usual for recruitment to include whole teams, forming an integrated skill set, if an insurer wants to enter a new class of business or defend an existing class for which another insurer has seduced the previous underwriter. Recruiting whole teams has the added bonus that it makes it much easier to attract the business that the team wrote for their previous employer, where there is then no-one left to handle the business. Because of the way work is organised, it is very risky to recruit a new underwriter, unless it is known beforehand that the person or team will fit into the existing structure. Technical staff in underwriting are harder to find, and are usually recruited through around half a dozen recruitment agencies specialising in insurance personnel with offices in the same area of the City.

Since senior, high quality underwriting staff are hard to find, they are given strong financial incentives to stay, and are required to submit to restrictive covenants when they leave to prevent them from approaching clients of their previous employer. However, these are hard to enforce, since the nature of the market is that clients, in the form of brokers, approach them.

There is some movement between the Brokers' employment market and that of the insurers. The skill-sets of the two markets are very different, and brokers moving to underwriting positions always have difficulty in acclimatising themselves. Traditionally, underwriters have held a higher status than brokers, so it was quite common for brokers to move to underwriting than the other way round, which would have implied a loss of status. Since the mid-eighties, it has become much more common for brokers to recruit underwriters in an attempt to acquire the underwriters' higher value skills. The move from underwriter to broker is much the easier to make, than from broker to underwriter.

- **Skills in financial and statistical analysis**

The continuing contraction of the Names' Agents' market means that there is an abundant supply of experienced staff available in the market. But, Names' Agents tend to define their resource problem in terms of lack of business, rather than lack of skills, so the instinct is to recruit people for the business they can introduce. This is not too difficult, especially as new employees are in a sufficiently weak position that they can be recruited on probation and largely on commission. However, the key skills of financial and statistical analysis now required by Names' Agents are those commonly found in the financial markets, not in the insurance market. This puts Names' Agents at a disadvantage in comparison with competing financial institutions, since the latter have better access to the financial markets, and are more accustomed to selecting and recruiting this sort of employee. Even more significantly, they have the resources to do so, whereas the Names' Agents do not. While financial institutions do not find it easy to recruit high skill analysts and salespeople, this may reflect the difficulty of finding people who will fit into a tight-knit team, rather than the difficulty in finding such skills per se.

- **Technicians skills**

Technicians are relatively hard to recruit. While brokers are out-and-about in the course of their duties and are easy to identify and approach, technicians are mostly desk-bound and less well-known to potential employers. Recruitment of technicians, therefore, is usually done through agencies.

- **Clerical processing skills**

The main reported difficulty for the MSU is the problem of attracting sufficient people of the right calibre to handle processing work in Chatham. The aim in moving processing operations to Chatham was to site the office in an area that was heavily populated but not too affluent. It was thought this would ensure a good supply of suitable recruits, while lowering premises' costs. However, it seems that the increasing affluence of the whole of South East England has affected Chatham, and people are no longer attracted to routine clerical work.

6.4 Internal Skill Gaps

Table 4: Recognised and Unrecognised Skill Gaps

Skills	Lloyd's Brokers	Underwriting Lloyd's syndicates/ Managing Agents and ILU members	Capital Capacity: Names Agents and Financial Institutions	Members Services Unit
Management and leadership skills	*	*		*
IT/ICT	*	*		
Communication	*			
Technical (insurance)	*			
Technical (financial)			* *	

- **Management and Leadership**

Professional management skills in Brokers are developed very piecemeal. In one company the policy is to promote likely management material into a cadre of middle managers, from which senior managers are selected when they have imbibed enough management experience to take the next step up the ladder. This is a wasteful method, as good potential managers get bored and frustrated with the wait, which may be several years, and leave the company, taking their clients with them. Smaller companies maintained that there were not the resources available to carry a team of specialist managers who had no operational line function, or the resources to train technical insurance staff into management roles. There were also issues of internal politics and ownership, because the senior managers were concerned about sharing their control with a new generation who may be more professionally and managerially qualified than themselves.

A management skill gap in Managing Agents is being addressed since Lloyd's, together with the active support of the IUA, has been instrumental in forcing Managing Agents to confront this problem. This has been less of an issue among the companies of the Fringe, especially the subsidiaries of large overseas or Tariff companies, where there is a strong management culture and management skills have been recognised as a priority.

Senior managers in the MSU have identified an incipient succession problem as their lower levels of management come up to retirement and there are too few suitable replacements available. Existing front-line managers may not be fully capable of carrying out their duties, especially if the 'Peter Principle' had applied during the days when the whole of Lloyd's was heavily bureaucratic.

- **Information and Communications Technology**

Broker staff recognised IT as a separate skill, required by specialist IT professionals working in Brokers. It was taken for granted that staff would use the IT equipment in the office for the preparation of presentations, documentation and letters, and that some training would be needed. There was no mention of IT as part of a communications skill-set, although the use of networks is common in the market (one company represented is heavily dependent on IT for operational and intra-office communication purposes).

Among the underwriting staff at the 'Box', there has been a tendency for IT skills to be concentrated in the younger staff. This is a continuation and development of the time-honoured arrangement, whereby the senior staff carried out the underwriting and the juniors observed and discussed their actions, and recorded the business accepted and quoted. The juniors had to understand the business in order to record it properly. This was a crucial part of their training and has been very effective. Its continuation has meant that all data handling and record entry has been undertaken by younger staff, so senior staff have not had the opportunity to become familiar with IT. There has been considerable resistance to the introduction of IT by older staff, but this problem is receding as retirement and redundancy follow the waves of syndicate mergers that have swept the market. The number of active syndicates has reduced from nearly 500 in 1986 to about 150 today. There are no figures available for the average age of underwriters, but HR and Training professionals thought that it was considerably lower than it was ten years ago. Some Managing Agencies employ IT professional staff to manage their networks.

IT skills are recognised as important, but are not particularly valued at Lloyd's. Technical requirements are generally out-sourced, and Lloyd's itself has an IT contracting division to provide back-up as required.

- **Communication skills**

Communications skills are a fundamental part of a broker's skill. They almost define the job, and, for that reason, are largely taken for granted. In many respects, they are more significant than technical skills because it is much easier to teach technical skills than communications skills. There is no evidence of any awareness that the drive to increase the technical capabilities of the broking staff could just as easily come from training the technicians in communications skills, as by giving technical skills to the brokers.

- **Technical (insurance)**

The historical division of skills between technicians and brokers in Lloyd's Brokers is linked to the issue of technical skill development among brokers. As described above, the ability to communicate, and 'people skills' are considered to be the core skill set of brokers. Technical ability is a desirable skill, but has not been considered as essential. A good broker, with the back-up of good technical staff, is considered a very effective deployment of skills. The broker is physically out of the office for much of the day (in some companies, brokers are not permitted to remain in the office during the market opening hours), so technicians provide the cover for them. The efficiency of this arrangement is fairly questionable, as it pre-supposes that brokers carry with them sufficient skills to enable them to 'broke' their business effectively, while they are away from their technical back-up.

Hence, the relative deployment of communication skills and technical skills means that there are two skill gaps - brokers are deficient in technical skills, and technicians are deficient in communication skills - but only the former gap is recognised. This may be caused, in part, by the recruitment of managers from the ranks of brokers.

- **Technical (finance)**

Financial institutions suffer from short-term skill gaps in servicing the Lloyd's market, but these can be resourced from the wider financial markets and adapted by training and experience to the particular demands of Lloyd's.

6.5 Skill Deficiencies and Impacts

The recognition of skill-sets and accepting the value of skills are fairly new phenomena in the London insurance market, and so it is not yet sophisticated.

(a) Brokers

For example, it is indicative of the depth of skill gaps among Lloyd's Broker organisations that all participants interpreted 'skill' as meaning 'technical skill'. It was sometimes quite difficult to get them to see that work attributes required skills other than those supplied by specialists. This attitude was as true of HR professionals, as of brokers and technicians.

Similarly, the assertion that Brokers cannot support dedicated managers suggests that the scope for management development is limited. Managers will always be too thinly stretched to give the management of a company appropriate priority. This is a characteristic of small businesses, where managers and operational executives are one and the same people. Many Lloyd's Brokers are of a size where this concentration of roles starts to become a problem. While the training department of Lloyd's has been active in trying to promote the development of management skills, it has been less successful with Brokers than with other parts of the market. This may be because it has no direct control over Brokers, and a reducing amount of influence as the importance of Lloyd's slips in the global insurance market place.

The strong tendency to value highly technical insurance skills, to the exclusion of other types of skill, such as communication and management, may assist in helping the London market maintain its leadership in the global insurance market. However, it will not help individual companies to thrive as independent business units. The need for greater management skills, combined with the desire of more aggressive companies to gain direct access to Lloyd's and the London market, will lead increasingly to shifts in ownership and concentration of business. There have been several instances of large companies buying small Brokers to gain a foothold in the London market. Aon and Marsh MacLennan have been particularly aggressive in this respect, but Johnson and Higgins, Citicorp, HSBC and Jardine Matheson are also all directly represented at Lloyd's.

The development of electronic broking, and the reduction in face-to-face broking this will entail, means that the distinction between broker and technician will fade. This change will have considerable implications for the development of skills, as a significant proportion of brokers' skills is developed out of their contacts with insurers (which has been a significant element in their on-the-job learning). The change also has implications for the operation and organisation of Brokers' resources, as desk-bound brokers will have greater functional flexibility than brokers operating outside the office.

(b) Underwriters

As management skill gaps have been identified under external pressure, insurers have also realised that the skill-sets required of underwriters are not identical to those required by managers. Technical skills are easily available, and so gaps can be identified on a strictly 'ad hoc' basis and filled as required. Lack of technical skills is never so acute that it affects critical functions over an extended period. Only high-level skills are perceived as being a problem, and this can be addressed by offering enough money to suitable potential employees.

(c) Names Agents

The present strategy for Names Agents is to try to acquire business by recruiting people who can bring business into the company. These new recruits are paid on commission, and are on six month's probation, during which time they have to demonstrate their ability to attract business. Business can also be acquired by merging with other Agents and pooling resources. Acquisition of skills by both merger and recruitment has been common in the Names' Agents market. There is an explicit intention to recruit or develop skills to support the strategy of information-provision as soon as internal resources are adequate. But, up till now, this has not been possible, and the strategy to change the product mix has not been viable. Skills are not available internally, and the resources to acquire or develop them are not adequate.

Names' Agents recognise that they have a significant skill deficiency and that it is constraining their ability to develop a critical function. They also are aware that, without the right skills, they may not be viable. It is quite likely that drastic action will have to be taken to rectify the situation. It was not clear whether this might involve further consolidation within the Name's Agents market, or merger with a financial institution that is making a strategic move into the Lloyd's market. There are areas of strategic fit that would make the latter a very viable strategy. The Agent would acquire access to appropriate skills, to financial stability, and to a potential corporate capacity market, while the financial institution would acquire access to a potentially lucrative high-value, private client market.

(d) Management Services Unit

As the Management Services Unit started to evolve from a processing department in to a financial institution, it took the active step of recruiting a management team that reflected its new strategy. An IT professional with a financial background, an accountant with systems experience, and an insurance professional from the market comprise the new team. This bias towards system and financial skills has been very influential in the evolution of the unit. It has been able to utilise their expertise and contacts to recruit and develop a range of skills that would not have been available to a management team drawn purely from the insurance market. However, much management time and effort recently has been devoted to the design and installation of the new IT system, leaving very little time to handle the people management aspects of change. It is likely that there might be a slight backlog of people-related problems that need attention. Our evidence suggests that there may not be sufficient senior management skills to handle both IT and people issues simultaneously.

The continuing expansion of the tasks of the MSU is a specific response to a skill gap. The market and resources of the Names' Agents have collapsed at the same time as the demands on them and the skills required of them have started to expand well beyond their limited capabilities. The solution to this gap has been to centralise the financial operations previously carried out by Names' Agents into one unit, where the demands can be met and economies of scale in financial and skill terms can be obtained. The MSU has been obliged to recruit staff with relevant banking experience to resource its newly acquired tasks of share management, custody and financial service. These skills were not available in Lloyd's, or even in the insurance market, so the MSU used its contacts in the financial markets to find the right people. There is concern that the demand for these skills may increase, particularly in the field of financial services, although the customer base may diminish. This is because many of the names are elderly and are confused by the immense changes that they have seen to Lloyd's over the last ten years. The MSU report that they spend a considerable amount of time supporting these Names on issues that may be only tangentially relevant to their membership, and they do not have the skills to do so effectively or efficiently.

Innovative recruitment techniques and working practices, such as home working and flexible hours have overcome the recruitment problem of clerical staff for MSU at Chatham to a large extent. Increasing use of the IT system to reduce the dependence of the process on manual effort may also alleviate this problem, but the new system has not been in place long enough for this to be tested.

The essence of the strategy at Lloyd's is to respond to the demands of the market it services and to make the operation of the market more efficient and cost effective. As the market shrinks numerically, the volume of skills necessary to fulfil the strategy reduces, although the range may increase as the market becomes more complex. The MSU, in particular, expects volumes to reduce following the introduction of specific charges for specific services. Previously, up to December 1998, charges for services such as custody and fund management were bundled in with the rest of the Lloyd's fee. However, they are now charged explicitly, which puts the MSU in direct competition with other financial institutions offering this type of service, and already a fall in demand is reported. The MSU does not need to recruit extra skills to cope with this change in strategy. The fall in demand may mean that some of their skills are numerically redundant. Marketing skills may be needed to ensure that the demand does not fall too far, although this point was not raised or discussed.

6.6 Skill Deficiencies: An Assessment

The London Insurance Market is a business district specialising in risk transfer within the larger business district of the City of London. It is a global centre of excellence and attracts business from all over the world by its reputation for innovation and skill in being able to handle large and complex risks. It is surprising, then, that until recently, the perception of skills has formed such a small part of their product strategy. One cause of this is that London insurers enjoy the benefit of a large skill pool from which skill needs can be resourced very easily. This has meant that it has not been necessary to plan ahead. Another cause is that management functions have generally been performed by senior technical staff who have placed a huge premium on technical skills at the expense of any other form. Management skills have been developed internally and piecemeal. Technical IT skills have been bought in, but operational IT skills have been developed 'ad hoc'. Communication and attitudinal skills have been largely taken for granted.

The crisis at Lloyd's has resulted in a change in the structure of the market and in the way it resources its capital capacity. The corporate capital provider has supplanted the capacity provided by the individual private Name. Whereas Names were firmly discouraged from asking questions, corporate providers are very demanding in their approach and expect professional management structures and reporting procedures. This has resulted in Lloyd's Managing Agents recruiting professional managers to supplement their home-grown resources. These initiatives have been strongly supported and mirrored by the IUA, who have been working with Lloyd's to ensure a coherent skills-development and training policy. The regulatory environment has become much more stringent, with Lloyd's and the FSA imposing increasingly strict compliance procedures on syndicates and Managing Agents.

The combined effect of compulsion and commercial interest has been to raise the awareness and appreciation of the importance of skills to the market. There is a glut of technical skills on the market at the moment, following successive restructuring and downsizing exercises. There is no concern that this glut may be temporary - indeed, one senior market figure suggested that it could be almost permanent. There is some concern that the development of network trading and associated changes in working practices may disrupt the process of tacit skills development that has characterised the technical skills market. The concept of 'insurance as a product' is deeply ingrained in the market, despite the best efforts of Lloyd's and the IUA, who have tried to move people away from the idea that they offer a product. However, this is not well understood by the insuring community, or the Brokers. Only the HR professionals appreciated the idea that a network trading capability itself might be a service. This did not occur to insurers.

Nowadays, almost all financial transactions within the market are handled electronically, but the front office processes - broking, underwriting and capital provision - are still very personal, and the market has exerted an enormous inertia on the change process. However, recently, a number of large insurers, brokers and reinsurers have committed themselves to using e-commerce in the global commercial insurance market to reduce processing and administrative costs through WISE. WISE is a co-operative venture, established in 1999, to combine the activities of three industry networks - RINET linking continental European insurers, WIN a global network owned by the world's four largest insurance brokers, and LIMNET which links the London Insurance Market. WISE offers an internet trading environment across the commercial process - marketing, negotiation, placing of risk and claims notification and settlement.

The skill implications of this are considerable, but were not raised in interviews to any significant extent. There was no perception that e-based trading might demand new skill-sets, or new mixes of existing skill. This may indicate a significant latent skill deficiency in two areas. First, it will blur the traditional distinction between the broker, who places the business in the market, and the technician who provides the back-up services. Keeping the brokers out of the market and at their terminals may seem an efficient use of their resources, but they may not have the right skill resources to perform their tasks properly, and will be denied the opportunity to develop new skills and knowledge by their interaction with other market experts.

The second area of latent skill deficiency lies in the field of knowledge management. The London market has evolved an astonishingly efficient method of knowledge development and dissemination through the interaction of brokers and insurers in the course of their trading. Knowledge is gained and techniques developed in response to specific problems and issues in the market. This is passed from underwriter to broker and from broker to other underwriters, without either party being aware of what is happening. As the market moves to electronic trading, this casual interaction will atrophy and disappear. It is a valuable resource, but it is not valued in the market and there is no mechanism to replicate it, although the technology exists to do so and even to convert it into a strategic advantage.

APPENDIX 1:
CASE SIZE, PERFORMANCE AND SIGNIFICANT EVENTS

Case Company	Employees in UK Country of Origin	Performance (last 12 months)	Significant factors
B1	5,000 US	Higher than average	mergers and positioning for Europe
B2	1,250 UK	20% growth	acquisitions and positioning for Europe
B3	4,500 UK	12% rise in operating profit	serious decline in 2 major sources of profit
B4	>40,000 UK	10%+ rise in pre-tax profits	consolidating merger
B5	2,500 UK	13% growth	threats to Mutuality
B6	1,400 UK	10% growth	threats of M&A
B7	1,000 European	10% on investment	alliances and mergers towards consolidation of insurance and investment banking
B8	40,000 in 150 companies	no consolidated figures available	International operations and 'Fringe' activity
B9	8,000 in over 73 companies	no consolidated figures but Lloyd's income is declining	M&As
B10	300 in 8 companies	86% decline in market over 10 years	MSU establishment
B11	700, with 250 in MSU	not available	Monopoly supplier

APPENDIX 2 :

PRODUCT AND MARKET CHANGES IN CORPORATE/ INVESTMENT BANKING AND FINANCIAL SERVICES

Case	Major client group(s)	Product/services offered	Changes
Finco1	Wealthy individuals Corporates (all sizes, often MNEs) Governments and Institutions	Banking and full range of financial services Global custody and FX processing facilities Investment banking Complex financial instruments	US-based, but has developed its UK presence to grow business in European and nearby regions. Particularly taken advantage of growth in business created European M&A's activity. Seeks to work mainly with top-level clients. Underpinning this drive is increasing pressure for delivering improved shareholder value.
Finco2	PLCs below the top 100 Broking companies Middle market corporates	Asset finance Market making Independent financial advice	Until recently, confined itself to servicing UK-based SMEs, but has been undertaking alliances with European firms and buying businesses to meet its own and clients' changing needs with the move into European markets. Strongly driven by delivering shareholder value. Seeks to be a leader in chosen markets rather than diversifying.
Finco3	Corporates Financial institutions	FX payment Outsourcing FX	Reshaping of the Group's business portfolio. This involved a fundamental refocusing of financial service business. Focus has moved from individual customers to increased business with corporates and Financial Institutions.

APPENDIX 3:
PRODUCTS AND MARKET CHANGES IN RETAIL BANKING AND FINANCIAL SERVICES

	Major client group(s)	Product/services offered	Changes
Finco4	Individuals SMEs	Broad range of branded services including mortgages, retail investments, credit cards Private banking and stockbroking Business banking, new business advice Asset finance Insurance and investment	Strongly driven by the aim of delivering outstanding shareholder value. Focused on meeting UK market needs unlike less successful competitors who sought to operate in more global markets.
Finco5	Individuals Affinity groups	Mortgages Savings	Retained its mutual status against opposition.
Finco6	Individuals SMEs	General insurance products Independent financial advice	A large insurance intermediary, wholly owned subsidiary of a UK-based financial institution which provides the leads. These are a declining market so cold calling a new market segment

APPENDIX 4:
DEVELOPMENTS AFFECTING NAMES' AGENTS IN THE LLOYD'S MARKET

1991 to 1998 saw mass resignations of Names (individual investors), and numbers fell from over 28,770 to 6,825 in 155 Syndicates. Capacity declined as well, but in a smaller proportion, as the resignations were mostly smaller Names who realised that they were over-exposed. In 1994, in order to maintain premium capacity, Lloyd's introduced a new category of corporate Name. Companies, not necessarily insurance companies, could accept premium and pay losses in the same way as individual Names but with the crucial difference that their liability was limited. Corporate Names numbered 435 in 1998 and now represent over 60% of total market capacity as the number of individual names continues to decline. Also, in 1994, responsibility for the management and distribution of Names' funds was transferred to the Corporation of Lloyd's Members Services Unit (MSU). This removed much of the raison d'être of the Names' Agents, whose significance to the insurance market has declined dramatically as a result.

Other business developments include the introduction of auctions of capacity, where membership of a syndicate is calculated as having a capital value in itself. Names are no longer introduced to syndicates on a handshake. They have to buy capacity from the syndicate or from existing Names who are resigning from Lloyd's or leaving the syndicate for some other reason. These changes have had a very profound impact of the Name's Agent as a profession. Their income is under pressure as their client base reduces. Their services are appropriate to private clients rather than to the corporates who now represent the bulk of their potential market. Corporates are much more demanding in their requirements. The Names' Agent's community has shrunk from a peak of 43 to its current level of eight, through a series of mergers and acquisitions.

Corporates tend to look for investment advice to the mainstream financial institutions that would provide them with access, analysis and commentary on any financial product. Several large financial institutions including HSBC, Merryll Lynch and Nomura have set up departments to supply this market. These compete directly and indirectly with Names' Agents although they do not deal with private clients.

Concentration of responsibility in the MSU for accounting and other services is held to have produced a number of beneficial changes. For example, information on Names' affairs is held in a consistent and readily accessible format, improving the flow of information between Lloyd's and Names: This is of particular significance to corporate names, which have greater information demands that traditional private names. There are economies of scale in the administration of funds and information, which benefit both type of Name. Also, members get the benefit of participating in much larger trust funds than could be amassed by individual Names' Agents. Of great importance is the removal of a conflict of interest for Names' Agents' need to collect losses from clients while also retain them. The down-side to the arrangement is that there is no competition for the MSU's accounting and information provision functions. It is a monopoly supplier and needs to be carefully monitored to ensure it is operating efficiently.

APPENDIX 5:
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