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It's the business model... Reframing the problems of UK retail banking

Abstract

This paper introduces and applies the concept of critical business model analysis to explore dysfunctional behaviour in the UK retail banking sector and to outline possible policy approaches. The paper starts from the conventional micro-economic framing of banking as the outcome of insufficiently competitive markets, yet after two decades of policy responses the sector is not only more concentrated but also homogeneous, dominated by financialized organisations focused on sustaining high rates of return on equity. Critical business model analysis is used to reframe the banking sector as one based on mimetic behaviours, including mis-selling of financial products and opaque charging. In doing so, the paper contributes to the public debate on the reform of retail banking by highlighting the potential importance of a wider diversity of business models within the sector as a way of offering customers a different choice and limiting the scope of financialized practices.

Keywords

Critical business model; UK retail banking; competition; shareholder value; stakeholder credibility, financialization.

1. Introduction: banking failure and reform

Which? launches a major new campaign, 'Big Change', today calling on the banks to put customers first not bankers, as new research shows that banking is one of the least trusted professions. Two-thirds of people (67%) think that bankers are unlikely to lose their job if they lie or cheat, a new Which? survey found. A similar proportion think bankers are unlikely to lose their job if they failed to comply with industry codes of conduct (63%), delivered consistently poor service (64%) or received a high number of complaints from customers (64%). Only one in 10 people (11%) say they trust bankers to act in their best interests. More people say they distrust bankers than estate agents (65% compared to 51%) and a mere six per cent of people say they associate ethical behaviour with bankers. Just one in ten (10%) think that bankers are well regulated.

Which? Press release, 19th September 2012 (Which? 2012).

Ahead of this time's crisis, financial and human resources were diverted away from retail banking services and non-bank activities towards investment banking. At the same time, the culture and practices of investment banking infiltrated retail banking - a sales culture which culminated in harmful cross-selling and unlawful mis-selling.

Andrew Haldane, Director for Financial Stability, Bank of England, Speech at an Occupy event, 29th October 2012 (Haldane 2012).

Declining trust in UK banks and bankers are manifestations of significant problems in the retail banking sector. A series of spectacular banking crises, including Northern Rock and the Royal Bank of Scotland (RBS), as well as widespread and persistent mis-selling¹ of financial products, have reinforced a view that banks are not, contrary to much of their own marketing, primarily focused on the interests of their customers. While much has been written about the banking crisis and the collapse of individual institutions (Engelen et al. 2011; FSA 2009; Shin 2009; Treasury Committee 2009), this paper takes a wider focus on the UK retail banking sector. The official response has been to see the ways that retail banks appear to act against the interests of their customers as problems that arise from a failure of competition. However, this micro-economic framing narrows the analysis onto the market; the framing also creates a circular process of diagnosis of insufficiently competitive markets, leading to various - ineffective - attempts to create more competitive ones. In this way, framing represents a selective social construction of a problem and its associated remedy: frames are important because they organise and focus, necessarily leaving some issues outside the frame. However, where repeated attempts at change leave policy makers (and bank customers) frustrated, changing the frame might yield new insights and possibilities for reform.

Research from several fields has confirmed the importance of how problems are framed: whether it is Kahneman and Tversky's (1979) ground-breaking experiments which showed that individuals respond differently to questions of risk and payoff or loss, depending on how problems are framed; or Lakoff's (2004) analysis of how progressive politics in the US has failed to reframe social and economic issues in ways that allow more radical policies to be supported. Framing has become important in fields such as communication studies, to explore how problems are presented and interpreted. Such analysis finds that dominant frames can eventually become unquestioned, are

accepted by all parties and lead to a narrowing of the debate (Nisbet 2009). Conversely, framing can also be used in a critical manner, as part of collective action and to facilitate change, including through social movements (Gamson 1992).

The aim of the paper is, therefore, two-fold. First, it uses the concept of *critical* business model to explore the UK retail banking sector through reframing as dysfunctional business models rather than uncompetitive markets. The business model is usually understood as a representation of the collection of organisational actions taken to meet the organisation's primary objectives, typically to create value for customers and then to capture it as profit. Such actions cover products, markets, technologies and organisational architecture: taken together they provide a description of how the business 'works'. This can be enhanced through critical business model analysis to recognise tensions between interests, specifically how pressures to deliver shareholder returns create dysfunctional behaviours that affect customers, such as through promotion of unsuitable products, opacity of charges and regressive cross-subsidy. Second, the paper uses this analysis to provide a contribution to the debate on reform of retail banking. It is argued that critical business model analysis allows a reframing of what has gone wrong in retail banking in the UK and why problems persist. In contrast to the diagnosis of lack of competition, common to official reports and inquiries into the sector, a critical business model frame is utilised to look beyond the market for banking products and to explore how reform of banking can acknowledge the implications of an overly financialized, or return on equity led, approach to management. While recognising that all framings are socially constructed, and that no one framing can be complete, the choice is relevant in making visible the excesses ensuing from the financialization² of business models across a group of firms. The specific context is that of the UK; however, the narrow micro-economic framing of public policy problems, as well as the extension of financialized business models, have salience elsewhere.

Problems in retail banking pre-date the 2007-08 banking crisis and are largely not addressed in the subsequent official public debate about reform in the UK. This is obvious in the breakdown in the relationship between banks and their customers. A crude measure of this failure is evidenced by the British Social Attitudes Survey findings (NatCen 2010), as well as by the *Which?* Survey, noted at the start of this section. Such findings are seen as significant because it is most unusual for public attitudes to shift so radically, so quickly³. A contributory factor has been the series of mis-selling scandals; as noted in the quote from Andrew Haldane above, these suggest corporate priorities are on short term financial returns, not customer interests. Crude evidence for this claim can be found in customer satisfaction scores, for example those provided by consumer organisation, uSwitch, in which the big four banks (HSBC, Barclays, RBS and Lloyds) are placed in the bottom half across most categories⁴. Another, more powerful, confirmation of the claim can be found in the mis-selling of one particular retail financial product *payment protection insurance* (PPI)⁵ which was not only large in scale but also persistent and widespread: between January 2011 and March 2015, more than 20 banks and other organisations paid out £18.8 billion to compensate 13 million consumers (FCA 2015). Even after repeated instances of mis-selling, there is no assurance that these kinds of practices have ceased (Wilson 2012). The fact that so many mainstream retail banks are implicated in each mis-selling episodes suggests that the causes are not simply about culture in a particular organisation (though this may indeed be a contributing factor); instead it suggests that the cause may relate to how a group of banks operate.

Critical business model analysis is therefore used to make sense of collective behaviour in a sector or business activity like retail banking and the UK case used in this paper provides a particularly good illustration. This is a mature market in which key product groups, such as current accounts, savings,

loans and mortgages, are well established with innovation having relatively limited impact. Where innovation occurs, it is often supplementary to those core products and originates in investment banking, for example insurance products, or from advances in IT; however, these 'innovations' are quickly adopted across the market to enhance fee-earning opportunities, as illustrated by the PPI example given above. At the same time, banking remains important because social participation requires citizens and organisations to have access to basic retail banking services. In this sense, banking has, in principle, the characteristics of a utility - a service like energy, or water and sewerage, that all households and businesses require - where it may be hard to assess quality and where some kind of social or regulatory control is often necessary to prevent abuse of corporate power. On that basis, the limited official attention paid to retail banking business models, as opposed to the overall competitive conditions of the market, is striking.

The suitability of the UK as a case study for a critical business model analysis of retail banking is further underlined by the homogenisation of the sector over time. While a broader range of business models previously existed, these have been abandoned (Co-operative Bank) or pushed into the periphery (mutuals, credit unions); meanwhile, mainstream banking has strengthened its foothold on the UK market continuously over the past 30 years. The dominance of very few (big four) banks with a substantial market share across the country is markedly different to other countries, for example, Germany where banking provides at least three generic business models (co-operative, saving and private banking); the US, where, despite the surge in national institutions post-2008, regional banking remains an important challenger to that national competition; or Japan, where the state-owned Japan Post Bank is the largest deposit holder. In the UK, even the Post Office is captured in a non-compete arrangement as it acts on behalf of most UK banks (including the big four). Hence, even competition for local services is effectively absent in the UK context as many banks can continue to offer services through the Post Office without a physical presence.

The next section of the paper interrogates the conventional framing of retail banking in terms of uncompetitive markets. It outlines the causes and effects of three cycles of policies which were intended to improve competition since the 1980s, but which resulted in a homogenisation of business models. Section 3 explores how a critical business model analysis can be used to reframe the problem of retail banking at the level of the sector. In section 4, this alternative approach is used to explore how strong adherence to a financialized business model has led to a focus on cost reduction, an opacity about fees and charges for the consumer and a retreat onto property lending. Based on this empirical evidence, the conclusion argues that the critical business model provides a useful way to think about reform of retail banking by highlighting the interests of service users and the community more widely at the level of the sector to explore public interest and make relevant interventions in current debates.

2. Framing UK retail banking as a problem of competition

Essential parts of the UK retail banking sector lack effective competition and do not meet the needs of personal consumers or small and medium sized enterprises (SMEs), two studies by the Competition and Markets Authority (CMA), published today, have found...The CMA and FCA [Financial Conduct Authority] have carefully considered a wide range of recent regulatory initiatives and other developments designed to improve competition. These

include initiatives to make the authorisation regime for new banks simpler and faster, to make switching easier and also to improve transparency. However, despite these important developments, and evidence of new entry, the market studies have identified a number of common concerns, together with evidence that competition is not effectively serving the interests of SMEs or PCA customers.
(CMA 2014b)

In late 2014, the UK's Competition and Markets Authority (CMA – see Appendix A for a full list of abbreviations) announced that it would launch a full investigation into personal current accounts and small business banking, the two largest volume products in retail banking. This was a significant move, only possible if an in-depth 'market analysis' found evidence of a lack of competition damaging to consumers (CMA 2014a; CMA & FCA 2014). The process is lengthy and onerous, including commissioned research, submissions from interested parties, site visits and hearings. The finding that there is a lack of competition in the sector was hardly a shock: this has been a concern for at least two decades and, although regulatory authorities had introduced measures explicitly intended to increase competition, the problems seem well-documented and persistent. As outlined in this section, a raft of measures addressing a lack of competition, taken over two decades have not led to any significant improvement, yet the diagnosis appears unassailable.

The question then is whether framing the problem of UK retail banking as one of 'not enough competition' provides a too-narrow understanding of this sector. After outlining the significance of framing, this section considers the development of retail banking in the UK, to illustrate the importance of competition in the official debate, where the number of banks (especially of new entrants) and the behaviour of customers (especially how often customers change their bank) become key indicators of whether the market is sufficiently competitive. As demonstrated below, the sector is not only more concentrated, but it becomes more homogeneous as shareholder value-driven banks grow through merger and acquisition.

The notion of framing has been of interest to a range of writers, especially in the area of political communication. As Entman notes, 'to frame is to select some aspects of a perceived reality and make them more salient in a communicating text in such a way as to promote a particular problem definition, causal interpretation, moral evaluation, and/or treatment recommendation' (1993, p.52). At one level this seems obvious: most frameworks are what Goffman terms 'social', not 'primary' in that there is a 'live agency' providing a guide for what can be done and creating apparent standards for social appraisal, management and control (1974, p.22). Thus in an economic system that privileges a notion of markets as efficient institutions, the appropriate functioning of a market will depend upon it being competitive. The frame then guides the design and work of regulatory organisations like the CMA, whose role is to monitor and evaluate the extent to which particular markets fail to be sufficiently competitive through statutory forms of 'corrective control' (Goffman 1974, p.22). In doing so, it supplies Entman's 'moral judgments', which reinforce the frame (1993 p.52). As Bowman *et al* (2014) observe, the competition frame has become particularly dominant in all manner of problems of public policy.

Interrogation of the frame helps to make sense of why it becomes hard to escape from a circular kind of problem diagnosis and prescription, even when there is evident failure of understanding and action. Of course, the existence of the frame reflects the ideological interests that can create and sustain categories of worth or significance, often displacing 'rigorous analysis' (Edelman 1993).

Tracing back from the categories to the interests is useful because it helps to explain why one set of interests⁶, the retail banks whose competitiveness is questioned, do not challenge the framing that comes from the institutions of the state. The history of UK competition policy is one of largely modest action, notwithstanding sometimes strong-sounding language. As argued in this section, an endless concern by policy makers to enhance competition has done little to change the behaviour of the dominant market actors.

In the case of retail banking, the framing leads to salience in the form of measures that are ‘noticeable, meaningful or memorable’ (Entman 1993, p.53). Hence the regulatory concern with market share and with customer switching, as indicators that appear to address the way that markets present choices and the ability of customers to respond to such choices. Here, the consumer’s choice of a bank stands in for any wider set of options about forms of banking or service; and the metrics become essential as regulatory heuristics that drive policy prescriptions. Even after the banking crisis and various domestic scandals, the frame persists: framing works, of course, through omission as well as selection (Entman 1993, p.54; Edelman 1993). The analysis of business model in the next section is thus a way to challenge omissions in the standard frame by understanding how sustained financialization creates particular behaviours and outcomes. First we explore the dominance of competition.

The merry-go-around: competition cycles and policy failures

Competition has been a driver for government policy on retail banking in several ways. Following the secondary banking crisis in the 1970s, the Bank of England’s response discouraged competition between retail banks (Regan 2008), yet a decade later the government deregulated financial markets and encouraged competition (Central Banking 2012). Since the Big Bang in 1986⁷, increasing competition in banking has remained a key concern of policy makers: this can be understood as three policy cycles (as shown in figure 1), focused respectively on demutualisation, online banking and new entrants. In each cycle, the aim has been to directly encourage (or, in the case of online banking, assume) that a combination of new entrants - so-called challengers - and growth of minor players, would increase choice for customers and produce a more efficient sector. If the aim was more competition, as outlined below, the outcome has been perverse, leading to further consolidation and homogeneity.

INSERT FIGURE 1 ABOUT HERE

The demutualisation of building societies⁸ from 1989, following the 1986 Building Societies Act, represented government ambitions to create challenger banks to compete with incumbents more effectively (ICB 2011). The rationale for demutualisation, efficiency and improved ability to raise capital, was argued to benefit owners, customers and the public: larger banks were seen as more competitive, passing-on savings to consumers (Klimecki and Willmott 2009). The Act was successful to the extent that many building societies demutualised (with significant windfall gains for members), but their inability to compete effectively against the big four (HSBC, Barclays, RBS and Lloyds), more or less led to their disappearance through mergers and acquisitions (M&A), in particular by shareholder owned banks (BSA 2014a)⁹. Even more problematically, the few remaining mutuals

succeeded only because, first, they adopted operational procedures similar to those used by incumbent banks and, second, they financed their activities through short-term funding provided by the markets to expand mortgage lending in the pre-crisis property boom. Ultimately, demutualisation was a failure in terms of enhancing competition: no single demutualised building society remains in existence as an independent brand; and successive take-overs have further increased the market power of incumbent high street banks (The Treasury Committee 2011: 206). Nor did demutualisation appear to improve cost efficiency for consumers despite a positive impact on profits (Berger 1998: 79), though it proved lucrative for senior management (Shiwakoti *et al* 2004). Ashton and Pham note that, while there were little or no efficiency gains from consolidation, the negative impacts on customers and employees have been more marked (2007: 5f).

While the building society sector was gradually demutualising and consolidating, M&A between established banks in the 1990s and early 2000s¹⁰, helped to move retail banking even further away from the aim of more competition. Prompted by concerns that this initial wave of M&A had left a sector that did not serve customers well, UK government commissioned the Cruickshank Report. This very critical report found '*competition problems... in all markets investigated*' (2000: viii). It estimated that such problems cost consumers £3-5bn annually, and recommended some restructuring to allow competition to develop, though Cruickshank shied away from demanding a break-up of the big four banks. The report attracted some interest in the press about poor treatment of customers, but politicians had no appetite for significant regulation. Thus the second competition wave lacked a clear set of legislative or regulatory tools. According to some commentators, government and regulators had hoped that the market would resolve the problem, with particular importance attached to the anticipated positive impact of new (internet-based) entrants on bank behaviour and product markets (Packard 2013; McKinsey 2014). However, this competitive threat never materialised in the UK as online services were quickly adopted by incumbents. Most of the online start-ups either failed or were acquired by incumbents, thus sustaining what increasingly appeared to be a retail banking mono-culture; and insufficient competition remained the official verdict on the sector (OFT 2008: 11-15).

However, while official policy on retail banking was to encourage competition, this was undermined in the midst of the financial crisis when Lloyds Bank was pressed by the government to take on the failing Halifax-Bank of Scotland group (HBOS), in the process increasing Lloyds' market share to 30% (*Financial Times* 2009). Other consolidation was also permitted to avoid the collapse of weaker players: thus Santander acquired two major former building societies, Bradford & Bingley and Alliance & Leicester; while the Nationwide (the largest remaining mutual) acquired several smaller building societies. Some of this may have been necessary to help stabilise the financial sector, but it further increased the concentration in key retail banking markets: five providers now had market shares of 85% in current accounts and 89% in small business lending (OFT 2008). Moreover, the post-crisis period in UK financial services saw a marked decrease in Michie and Oughton's *Diversity Index*¹¹ to below 85 in 2009 (2000 = 100) for mortgages and savings (2013: 23).

Having encouraged stabilisation through consolidation, UK government and the regulatory authorities launched a third wave of officially-encouraged competition, this time with particular emphasis on new entrants or 'challenger'¹² banks (HM Treasury 2012). This incorporated three approaches: first, sale of nationalised banks (e.g. Northern Rock) to private investors; second, divestment of assets from banks that had acquired failing mid-sized banks at the beginning of the crisis but then required a government bail-out themselves; and, third, promotion of mutual

challenger banks, thus effectively re-appropriating the bail-outs as policies to scale-up mutually-owned banks.

Post-crisis ambitions to establish a major new challenger have had limited success. The Independent Commission on Banking (ICB), set up to investigate banking failure, initially recommended divestiture of Lloyds and RBS assets to create a government-supported challenger bank with a personal current account market share of at least 6% and a strong funding position (The Treasury Committee 2011). This was rejected by government, which opted for a market-based option to keep Lloyds as a strong player in the market and to create a new bank, TSB, by divesting 600 branches from Lloyds. Having failed to find a private buyer for these assets, they were partially floated on the stock exchange, quickly followed by a takeover bid from Spanish bank, Sabadell. Likewise, majority government-owned RBS is preparing the divestment of its Williams & Glyn brand. Whilst this suggests some change within UK retail banking, past experience suggests that many of these competitors could quickly disappear.

The introduction of wholly 'new' players to the market is equally problematic because capital requirements, market access and limited brand recognition limit growth potential. Small scale providers of retail bank services (e.g. Metro Bank, OneSavings Bank), are far from competing head-on with incumbents. In other cases, it is difficult to anticipate independent new banks: recent flotations (e.g. Virgin Money), or ambitions to float challenger banks in future (e.g. Metro Bank, Aldermore) could quickly lead to their sale (*Wall Street Journal* 2015); at the very least, they put those 'challengers' under the same pressures from shareholders to maximise returns as currently faced by incumbent high street banks.

Although these three policy cycles sought to increase competition, the outcome was the opposite: a recent update of Michie and Oughton's diversity index (BSA 2014b: 3) shows that attempts to increase diversity in UK retail banking delivered no improvement on 2009 figures (for mortgages and savings), with both indexes remaining below 85% of the 2000 values. Not only have assets become concentrated, but market shares have also been transferred from mutually-owned to shareholder-owned banks in the process, producing a virtual monoculture of ownership where 'everyone play[s] the same game at the same time' (Haldane 2009: 19).

While increasing the number of competitors has been a major focus of policy since 2008, a second salient indicator has been the extent of customer switching. Not only are customers encouraged to change their provider if they are not content with the service provided (OFT 2013), but actions taken by the regulator are intended to make it easier to switch, thus incentivising banks to improve. The House of Commons Treasury Committee (2011) pointed out that personal current account transfer rates, estimated by the big four to be 7-11% per annum, were low compared with those of around 25% in other utility markets such as energy and mobile phones, implying that if the process was made easier, customers might be more inclined to change their provider. However, even this 7-11% figure was dismissed by a number of other banks, including Santander, Virgin Money and Tesco Bank, claiming that it is more likely below 5% (*ibid*: 39f). It could be argued that this customer inertia cannot, contrary to public policy, be solved only by making the process of switching simpler; it also requires customers to be able to make a choice between *different kinds of offering*. Given that banks tend to offer similar products on similar terms and conditions, while products and services become more complex and pricing increasingly opaque, it is not surprising that customers seem unwilling to change their bank.

Taking a twenty year horizon, UK governments and regulators appear to be stuck in a closed-loop process of repeated narrative about more competition and failed reforms. While concentration ratios are clearly high, this is an incomplete diagnosis reflecting a framing that ignores the implications of repeated policy failure. On this basis a different framing of the problem of retail banking - to provide insights beyond a micro-economic assessment of market characteristics - could be helpful: if banks are not pursuing the interests of customers, what is driving their behaviour? . The remainder of this paper takes this up through redefining retail banking dysfunction as a feature of the competition-focused business model.

3. Alternative framing through *critical* business model analysis

This section outlines how analysis of business models can be used to take the investigation of UK retail banking out of the dominant competition framing, which focuses on customers in the market. Instead, critical business model analysis can bring together analysis of the financial viability of the activity with a political economy-based interrogation of stakeholder interests and claims. To do so requires a shift from the business model as a diagnostic or normative tool, to a critical interrogation of how pursuit of credibility with some stakeholders may come at the expense of others. In particular, it acknowledges how generalised pressures like the financialization of corporations can reach beyond the individual organisation and influence the behaviour of a group of firms. Such analysis requires accounting and financial knowledges, rather than micro-economics-based paradigms of markets and competition. The section starts by outlining the rise of *business model*, before explaining how it can be deployed as a critical analytical tool, in particular to explore financialization pressures, relevant to the specific context of UK banking. The significance of a meso-level analysis is also highlighted, both in understanding mimetic pressures within the sector and, as the final section of the paper will explore, identifying possible policy implications.

Business model has become a popular tool for analysing organisational choice, challenge and development; a special issue of *Long Range Planning* in 2010 indicated that the concept had gained academic as well as business currency (Baden-Fuller *et al.*, 2010). As commentators have noted, its rise is both fairly recent (Ghaziani and Ventresca, 2005) and very often tied explicitly to the development of disruptive digital technologies (Amit and Zott, 2001; Chesbrough and Rosenbloom, 2002). There are many definitions of business model with slight differences in emphasis and orientation, and rather limited attempts at convergence and synthesis (Teece, 2010). As Zott *et al.* (2011) note, some applications are focused more on e-business models or on adaptation to technological change; in other contexts, business model has become a complement or even a replacement for strategy. Baden-Fuller and Morgan (2010) highlight the different meanings of 'model', drawing attention to the sometimes ambiguous ways that business model is used, to include scale models, ideal types, experiments and metaphors. Such ambiguity is reflected in Lecocq *et al.*'s (2010) comment, drawing on the work of Lakatos, that the development of the business model concept can be viewed as a 'research programme'.

At the simplest level, a business model is conventionally described or inferred as production, marketing, investment and other actions taken by an organisation to create and capture value. This is distinct from the focus on competitive advantage that underpins strategy. Although strategy and business model have some complementary features and, indeed as Lecocq *et al.* note, a business model might itself become the source of competitive advantage, 'the reflections of authors in the

business model program are more oriented towards revenues and costs, leading to a less abstractive view of strategy and organizations' (2010, p.217). This notion of business model is at once both immensely simple and adaptable, as it can be developed intellectually and practically to make sense of what businesses do. Moreover, the idea of capture as well as creation of 'value' can help develop a subtle understanding, because it helps recognise the difficulty some firms have in turning product or process advantage into profits. Notably many new economy firms create value for customers through offering novel services, but are unable to monetise this through customer charges, advertising or other sources of revenues.

While much of the literature has been published in business and management journals, business model is developing a wider importance, including growing interest by financial reporting professional bodies about the importance of a firm's business model to inform recognition, measurement and disclosure (EFRAG 2013, B.53). In practical terms there have been two kinds of effects. First, the notion of the business model has become more explicit in the development of accounting standards. As EFRAG (2013) note, 'business model' first appears in IFRS literature in 2009 in relation to IFRS9, where the specifics of the business activities have contributed to the development of fair value accounting, for example in the possible distinction for valuation purposes between assets that are part of operations and those used for trading activities. EFRAG (2013, B.52) and the IIRC¹³ (2013, p.2) both argue that business model should explicitly inform the development of the conceptual framework and corporate reporting. Second, in relation to disclosure, the business model is seen by some as a way 'to improve users' understanding of the firm and how it makes money' (ICAEW 2010, p.10). Indeed, the UK Financial Reporting Council revised the Combined Code on Corporate Governance in 2010 to include a requirement that the annual report should include 'an explanation of the basis on which the company generates or preserves value over the longer term (the business model)' (C.1.2). Similarly, the Accounting Standards Board (ASB) has noted that the annual report should include a description of the external environment and the business' 'economic model' (ICAEW 2010, p.10). In these ways, the business model concept has been integrated into professional accounting through regulation and reporting, though with limited academic debate about how this concept could be useful.

There is considerable flexibility about how to interpret these new disclosure requirements, perhaps inevitably leading, for example, to the use of 'boilerplate' (generic) language and a lack of structure which reduce 'disclosure quality' (IIRC 2013, p.4). Certainly, a snapshot of how major UK retail banks have addressed this requirement illustrates the limited insight that such business model reporting can produce. For example, Barclays Group Annual Report 2014 includes one page on 'Our business model', including a flow chart of how meeting customers' needs creates income and provides 'sustainable returns' as well as helping to 'create, grow and protect wealth' for society (Barclays 2014, p.6). Lloyds Banking Group provides a similarly generic description of how it meets customer needs 'through our distinctive strengths, in particular our range of iconic and distinct brands, our superior customer insights, high quality committed colleagues and relationship focus'; and in doing so 'believe we will help Britain prosper and create value for shareholders' (Lloyds Banking Group 2014, p.19). It is hard to see how such material will provide much useful insight for shareholders or any other stakeholders and it seems a long way from the serious intentions of the ICAEW and others.

Business disclosures will often be inhibited by concerns about commercial sensitivity but much academic discussion of business model also tends to focus on the apparent beneficiaries of value creation processes without recognising tensions and trade-offs. While 'value' is at the heart of the business model, the discussion of value creation tends to be rather descriptive, lacking (numerical)

analysis of the underlying processes. As a result, value creation tends to be ascribed to factors such as innovation or customer service, but with little examination of costs, returns or other data, which might sometimes challenge such assertions. In consequence, business model analysis is often devoid of critical (financial or political economy) insight: processes and outcomes of the creation of value are unexamined through failure to recognise that value creation (and its capture) can be understood as occurring in a political space, where interests have to be managed. This creates an opportunity for critical accounting researchers who appreciate the interplay between finance and political economy, as illustrated by work on fair value accounting (Müller 2014). Indeed, there are already notable examples where accounting approaches have made important contributions to developing the application of business model (see, for instance, Andersson *et al.* 2010, Gleadle *et al.* 2014 and Haslam *et al.* 2012, 2015). Moreover, critical accounting researchers also sought to link different risk profiles of business models and its relevance for accountants' ability to measure risk (Wright 2016) and how a broader, rather than narrow, use of strategic performance measures may result in improved stock market performance (Ittner *et al.* 2003) which mirrors the idea about shareholder value explored in this paper.

This opportunity to develop a critical business model analysis is taken up in this paper by following Froud *et al.* (2009), who argue that business models can be critically interrogated by exploring how organisations seek to meet the two related conditions of financial viability and stakeholder credibility. These are significant, because they shape the process of value creation and capture through the decisions made by an organisation about its activities and priorities, and with reference to the complex network of outside parties and interests. Financial viability does not imply any particular level or indicator of performance, recognising that these will be understood in the context of the organisation, its stage of development, industry and so on. Thus a not-for-profit financial institution will have quite different financial viability criteria to a shareholder owned bank; or a business in a mature market may have quite different opportunities to one experiencing rapid growth. This flexibility allows the critical business model analysis to be quite specific about sources of revenue, cost structures, investment decisions and other factors relevant to value creation opportunities and difficulties, rather than effectively viewing the firm as a financial black box.

The incorporation of stakeholder credibility into the analysis allows recognition of political economy: a business model only survives when the interests of particular stakeholders (whether consumers, shareholders, the state or others) are sufficiently met. Some stakeholders, like regulatory agencies and shareholders, will have more power to articulate and enforce their interests; the organisation will also have variable discretion about how it prioritises the interests of others to maintain credibility with the group(s) of stakeholders deemed most important at a particular time. In the context of UK retail banking, this is expressed by a clear focus on satisfying investor demands, suggesting that interest in customers is both conditional on the implications for revenues and costs or any specific action and undermined by awareness that customer have limited means of expressing voice if they are reluctant to change provider; indeed, given homogeneity in the sector, switching may appear to offer little benefit to customers in return for considerable inconvenience. New rules introduced after the banking crisis have required banks to recapitalise their balance sheets; increased amounts of equity needed to comply will reduce rates of return for any given level of profit. This may then lead to further disruption as banks attempt to maintain shareholder returns at the expense of other stakeholders. Thus critical business model framing provides a context-specific approach to analyse organisational behaviour and performance, recognising the dynamic interplay

with external actors and processes. Within this, narratives are important as devices of reassurance and persuasion in addressing credibility, particularly where business may struggle to deliver strong or consistent results. The articulation of the business model itself becomes powerful as a narrative device through implying control and distinctiveness (Magretta 2002).

More generally, critical analysis can recognise that business models have become financialized - adding a political economy sensibility missing from mainstream accounts - as the rise of shareholder value imperatives have tilted the hierarchy of stakeholder interests towards investors (Ezzamel *et al.* 2008; Gleadle and Cornelius 2008; Newberry and Robb 2008; Stout 2012; Cooper 2015). The ideology of shareholder value maximisation may not reliably deliver sustained enhanced performance, but the articulation of such priorities can have very disruptive effects on firm decisions and outcomes because it contributes to target setting and expectations around value creation and capture (Lazonick and O'Sullivan, 2000; Froud *et al.*, 2006; Jung and Dobbin, 2012). Several authors have highlighted the potential for financialized business models to distort corporate behaviour in particular ways. For example, Lazonick *et al.* (2013) have highlighted how Apple's business model produces extreme profitability and consequent distribution to shareholders which, they argue, is unjustified by any argument about risk or investment.

To date, most business model studies - those which comprise what Lecocq *et al.* (2010) describe as the development of the field through the stages of definition and empirics - have taken the organisation as the focus¹⁴. However, if critical business model analysis provides a way to explore how financialized firms attempt to achieve (investor) credibility, this can also be extended to frame problems that are experienced not just by a single organisation, but across a sector or industry. More specifically, how can the business model be used to analyse the failure of UK retail banking to meet the expectations of one group of stakeholders, its customers? Framing a problem that relates to a group of firms (not an individual firm) as a consequence of their business model not only offers a way to interrogate that sector but provides a distinctive means for developing policy responses. The competitive conditions certainly tell us something about the product market, yet the behaviour in that market reflects a business model shaped by factors such as ownership, cost structures, technology and regulation, much of which is in common for major players in an industry or sector.

Although firms in an industry 'compete' to varying degrees, there may be commonalities in the business model, reflecting products or processes, which help define the sector; these features may remain stable through periods of change. In other instances, changes in one part of the industry may lead to responses in the business model of other firms, thus creating a new order. For example, in the UK retail banking sector the introduction of the free-if-in-credit (FiiC) personal current account by Midland Bank in the mid-1980s was a potentially disruptive event that led to a shift in the business model of other players as they eventually followed suit. This meso-level view is important because it can reveal how some features of business models are mimetic: for example, the general acceptance of shareholder value contributes to creation of norms that shape how performance is measured, benchmarked and managed; such structures and goals then give rise to business model consequences for other stakeholders.

A higher level of aggregation naturally reduces the degree of definition of the individual firm, but offers an interpretation of broader socio-economic trends. For example, at a macro level, Lazonick (2005) has ambitiously described how 'the new economy business model' has brought about significant shifts in corporate behaviour in the US, including unprecedented growth of share buybacks and executive pay, which in turn contribute to lower investment and wealth creation in

the long term (see also Lazonick 2014 and Aglietta 2000). Here, shareholder value primacy, a common feature in the business model of a group of firms, is seen as leading to a focus on short term value extraction, rather than long term value creation that might be evident at the meso or macro level.

In this way, critical business model framing can be used to highlight problems that arise for some groups of stakeholders when firms (or groups of firms) attempt to meet particular financial objectives. Under some conditions, such as in markets where there is growth, there may be limited tensions between the interests of different groups of stakeholders arising from the business model. In other circumstances, it may be difficult to meet the expectations of key stakeholders – such as investors - leading to dysfunctional outcomes for others. Where a group of firms confront similar business model pressures, the effects can be magnified, creating problems that affect not simply discrete groups of customers or workers but society more broadly. The identification of sectoral characteristics is thus not an attempt to ascribe a simplistic story, or to assume a sector can be represented as a set of uniform practices, but it can help recognise commonalities reflecting significant changes in the external environment, technology, consumer preferences or so on.

The next section of the paper draws out some of these significant features¹⁵ of the UK retail banking business model as organisations try to achieve a level of financial viability consistent with the expectations of key stakeholders. The outcomes are important because the business model drives bank behaviour, leading to instability (even if shareholder returns may remain good for some banks), as well as creating wider social problems. As will be seen, exploring the business model of the sector not only helps to contextualise individual firm actions but also enables a constructive contribution to debate about reform.

4. Reframing UK retail banking as a critical business model problem

This section uses critical business model analysis to explore the financialized nature of UK retail banking. The model incorporates mimetic pressures to earn fee income from selling products, as the response to a consumer offer based on 'free' banking; this results in opacity to customers and a sectoral tendency to focus on property lending. This can be understood as a sectoral model because, while individual financial products are presented to customers as distinctive, the underlying pressures to generate income are similar. The financialization of the retail banks is evidenced by the emphasis on return on equity (RoE) measures to demonstrate financial strength, with incentive systems that reward senior employees; this is not simply about the setting of targets but about an expectation that those returns will be safeguarded during a period of change in the sector. Even after 2008, when returns fell due to lower income and higher regulatory requirements for capital, the pressure to improve returns has not been removed. The critical analysis of business model, therefore, reveals how stakeholder interests are variously accommodated and the ways in which financial viability is delivered through operating adjustments including branch closure and downsizing. In this sense, the usefulness of the critical business model approach can be interrogated through its ability to explore how (shareholder) interests format business practices within the specific (sectoral) context. This produces not a generic story about financialized business models, but a particular account of expectations about shareholder returns creating dysfunctional outcomes for another stakeholder, the banking customer.

Expectations and returns: the tale of UK retail banks

Changes to banking regulation since the 1980s have produced a financialized retail banking industry focused on growth and RoE targets. The deregulation of finance in the 1980s (Moran 1990) allowed retail banks to adapt their business models in a way that suited the interests of shareholders: this has enabled credit creation through consumer and mortgage lending, as well as a search for new retail financial products on which fee income could be earned. As a consequence, RoE has increased significantly in the UK, as highlighted by DeYoung and Rice (2004) and by Haldane (2011). Moreover, Haldane's data (adapted from Capie and Billings 2004) highlights how the distribution of UK bank RoE has shifted from one where over 30% of banks had a return of around 7% (until 1950) to a wider distribution peaking at returns of 25% between 1980 and 2010, as seen in figure 2¹⁶. This graph illustrates how market conditions may have restricted profit extraction from banking activities during the first half of the 20th century and how consecutive deregulation measures since the 1980s have led to a rightward shift in the distribution, with both a higher median return and a wider distribution as individual firm performance opens out.

INSERT FIGURE 2 ABOUT HERE

INSERT FIGURE 3 ABOUT HERE

The focus on RoE is not only a symptom of the expansion of investment banking which boosted returns particularly in the 2000s (as implied by Haldane), but a normalisation of expectations that retail banking should become a relatively high return activity at between 15% and 20% in most years between 2004 and 2011, as indicated in figure 3¹⁷. Retail banking makes a significant and relatively stable contribution to group profit for universal banks because it is less cyclical than investment banking.

As figure 3 shows, retail banking RoE remained at or above 10%, even during 2007-09; (and this is important because UK banks as a whole lost almost £30bn in 2008 and 2009, see BoE 2013) and contributed significantly to profit recovery in the post-crisis period, with RoE increasing sharply from 2010. Expectations of RoE have adjusted to a more difficult operating environment and regulatory requirements under Basel III, with expectations of 20% RoE in 2012 (Quarry *et al.* 2012), modified somewhat by 2015: as KPMG explains, 'banks need to work harder to become more profitable' (2015: .2). KPMG's retail banking review notes that the RoE of the five largest banks in the UK ranged from -8.0 to 7.8% in 2014, compared with an average of 17.7% in 2012 (KPMG 2015: 11). Nonetheless, all are targeting at least 10% for 2015-2017: for example, Barclays is targeting an 'average adjusted' RoE of more than 12% on its core business (Barclays 2014:17). Although bank profits have been hit by lower returns on investment banking activities and a series of fines and compensation costs for mis-selling and other problems including LIBOR fixing, profit from retail operations remains very high, indeed an 'astronomical' 30% for large players, according to one insider (Augar 2015). This is possible because some banking products remain very profitable: for example, Credit Suisse analysts estimate that retail banks achieve RoE of 24% on residential mortgages and 23% on credit cards (Antunes-Silva *et al.* 2013).

The principle of high-RoE retail banking is based on raising profitability through increasing revenues and reducing costs, while shedding low return activities and products, as outlined in this section. Thus retail banking products are assessed on their profitability and growth potential, as opposed to

the interests of the consumer. A high profile early adopter was Lloyds Bank, whose chief executive, Brian Pitman, wrote a stirring article in the *Harvard Business Review* in 2003 explaining the bank's singular and effective focus on shareholder value creation. The generalised nature of shareholder value pressures means that other listed banks have developed individual business models with similar features; we refer to these as *mimetic*.

A focus on cost reduction and revenue growth

Expectations of 20% RoE, which became normalised in banking before the crisis (Caruana 2012), increased the pressure on management to reduce the cost base. Selling products via bank branches in the UK typically accounts for 75% of total retail distribution costs (Bradey 2013;Quarry et al. 2012), estimated at around £800,000 per branch per year (Deloitte 2007). Retail banks have responded in two ways: closure of (often unprofitable rural) bank branches and the maximisation of revenue per branch.

Justifying branch closure has been relatively easy for the retail banks, at least for the first movers. Branch closures have been presented as the response to changing distribution channels (i.e. customer preferences) and not primarily as a cost saving or profit maximising exercise. There is clear evidence that direct channels – via telephone, online and increasingly using mobile internet – are used more, that fewer customers visit bank branches and that those who do visit, do so less frequently (Deloitte 2007). However, overall evidence that branch networks are becoming obsolete is weak. Although sales arranged in branches have declined overall from 94% in 2000 to 67% in 2010 (Capgemini 2012), the share of products sold in branches can vary significantly, depending on the type of product: for example, 75% of current accounts and 40% of personal loans are still arranged in branch (Quarry *et al.* 2012).

The density of the UK retail branch network is significantly lower than in other European countries: by 2010, there were 199 branches per million inhabitants in the UK, compared with the EU average of 463, as shown in table 1.¹⁸ Pressure to close branches remains: for example, in January 2014 Barclays announced a plan to close one quarter of its remaining branches, with expected cuts of around 1,700 retail banking jobs announced just two months previously (*Financial Times* 14 November 2013).¹⁹ In addition to shrinking the branch network, increasing revenue per branch is an important feature of business model behaviour. Even small increases in income can translate into significant increases in profits given high fixed costs. In line with a more limited network, average core retail banking product²⁰ turnover per branch is substantially higher for UK retail bank branches (£4.36m), compared to those in other main European markets (Deloitte 2007).

INSERT TABLE I ABOUT HERE

These cost and revenue pressures in the critical business model have a significant effect on customers within the UK. Closures affect urban and (especially) rural areas: by 2012 there were 1,200 communities without any retail bank branch, and a further 900 with only one (Quarry *et al.* 2012) so that some local markets are under-served. Interest rates paid on small deposits (up to £1,000) also differ significantly across England and create regional retail banking markets; for example, banks in the South West pay almost 0.7% higher interest than banks in the North East

(CCBS 2013). Under-provision of branches in rural areas is not alleviated by new entrants, as these players prefer to open branches in urban areas. In effect, new entrants tend to centralise bank provision in built-up areas, leading to relative overprovision which could cause further branch closures of incumbents. If financialized behaviour leads to cost-cutting in the branch network, the business model also creates further potential problems for the consumer in the form of a highly opaque customer proposition. Although, as the next part of the argument explores, customers may believe that they benefit from 'free banking', in practice this creates pressure to derive revenue from selling; with all kinds of hidden cross-subsidy of some consumers by others.

The promise of free banking, the rise of confusion marketing and the importance of cross-selling
The creation and spread of Free-if-in-Credit (FiiC) personal current accounts (PCAs²¹) since 1984 is a distinctive feature of UK retail banking, and one which clearly separates it from *Management Fees* and *Transaction Fees* models employed by other European banks (Ashton 2009: 50). This kind of personal account, which provides banking services at no charge to those with positive balances on their accounts, allowed its originator Midland Bank to gain almost half a million new customers within a year; the product was then rapidly adopted by other banks, transforming the industry and creating a PCA market defined by opacity and cross-subsidy. The notion of a 'free' service is interesting in a critical business model context because the bank will then generate revenues from other sources, hence the importance of cross-selling additional products for example, insurance, loans or credit cards to existing customers. This was explicitly highlighted in the Initial Public Offering prospectus for the TSB Bank, which cites the importance of PCA holders for cross-selling opportunities (TSB 2014, p.59). The PCA is thus regarded as a 'gateway' (CMA 2014a, p.48) or 'key relationship product' (defaqto 2012, p.2) that provides access to selling opportunities. Research by Mintel has found that cross-selling is particularly important for some products including cash savings and credit cards (CMA 2014a:48).

Pressure to cross-sell to existing customers to improve profitability has contributed to a series of mis-selling episodes. The scale of redress required by regulators to compensate customers who have been mis-sold products gives some indication of the sheer extent of the problem. For example, payment protection insurance compensation reached £20 billion by 2015, while the mis-selling of interest rate hedging products to small business had by 2014 led to £1.5 billion of bank provisions. The total effect of penalties and customer redress is staggering. For the five largest UK banks the cumulative cost between 2011 and 2014 is £38.7 billion, equivalent to 60% of profits made over the same period (KPMG 2015, p.2). This has had a significant effect on RoE and increases the pressure to find new revenues and to reduce costs further.

Even where mis-selling does not occur, there remains a problem about opacity. The cost of PCA provision is hidden as a consequence of confusion marketing that stresses the free-if-in-credit element. Although the banks do not directly disclose the cost of FiiC PCAs, these have been estimated at around £85 per account, considerably less than the annual revenue earned of £146²² (OFT 2008)²³. A break-down of PCA revenue in figure 4 illustrates how costs are recovered from customers in different ways, with net credit interest (NCI) and 'insufficient fund charges' as the largest contributors (OFT 2008). While there is no direct charge for 'free' accounts, these PCAs have an implicit cost to customers because the interest paid on balances is significantly below the Bank of England base rate; this generates almost half of PCA revenue in 2006. Moreover, the UK FiiC PCA market is defined by the cross-subsidy of customers who remain in credit and pay no direct charge for banking services, by those who pay to use overdraft facilities (predominantly via insufficient fund

charges), by those who buy other products from the bank and by those with high savings balances, as figure 5 illustrates. The current system particularly affects the most vulnerable who pay a large proportion of overdraft charges (around £20 per item), easily leading to an annual bill of over £100, and cross-subsidising those 70% of consumers with average balances who do not pay any overdraft charges. Overall, there is a lack of transparency: the 2014 CMA investigation of personal current accounts did not investigate the issue directly but reports the view – based on conversations, submissions and other evidence – that there is evidence of cross-subsidy, between products and between customers (p.47).

INSERT FIGURE 4 ABOUT HERE

INSERT FIGURE 5 ABOUT HERE

Income streams have shifted post-crisis, affecting the business model of all retail banks: net credit income collapsed as the official bank rate dropped to 0.5% (figure 6), and as unauthorised overdraft charges declined because regulators imposed restrictions on charges.²⁴ However, other charges became more significant from 2007-2011, including those for authorised overdrafts (from £14m to £448m), packaged current account fees (from £742 to more than £1,000m) and interchange fee revenue (from £568m to £814m) (The Treasury Committee 2011:32). Although there were concerns that the FiiC PCAs might disappear with lower interest rates, banks have offered alternative products, some of which may provide fewer benefits for consumers. Indeed, the rise of the ‘packaged account’, which offer the consumer basic banking plus additional services for an average monthly fee of £10-£20, which grew from six million in 2006 to 14 million accounts in 2011 (FSA 2012). This type of account also allows retail banks to sell unsuitable products to customers via the bundling of services, and to generate additional income by cross-selling banking services, insurance policies and unregulated services to consumer. The FCA noted in 2014 that even ‘astute customers’ would struggle to understand what they were paying for (2014, p.53).

Such PCAs perpetuate problems of opacity and mis-selling, as customers must choose between alternative bundles of services, rather than choosing those services that they need (purchased from different suppliers, as appropriate)²⁵. Around 65% of account holders use the most popular benefits (travel & mobile insurance, interest-free overdraft), but 30% of consumers do not use any services offered (OFT 2013). The retail banking business model has thus continued to lead to dysfunctional outcomes for customers with a rise in the number of mis-selling claims against banks for packaged current accounts. Even while the banks have been making huge provisions for mis-selling PPI, they appeared to be building up future claims of mis-selling on other products (Boyce 2014; Dunn 2014); indeed, some banks have withdrawn packaged accounts following much tighter scrutiny by the FCA (Jones 2013), leaving them searching for new products on which to earn fees. The wide-scale selling of a host of products unsuitable for many customers by the UK’s major retail banks underlines the problems of a business model mainly focused on credibility with shareholders, not with those who buy their products.

INSERT FIGURE 6 ABOUT HERE

This lack of focus on customer interests is exacerbated by customer inertia. Viewed from a critical business model perspective, inertia is not simply a symptom of a lack of competition but also a foundation of the model. Given that over half of customers have held accounts with the same provider for more than ten years (Mintel 2012), marketing is focused on recruiting first-time PCA holders who generally stay with the bank for some time and can be sold other products. This leads to further cross-subsidy to fund student accounts, for example, with free overdraft facilities up to £2,000, or credit cards with 0% interest for a certain time. These ‘gateway products’ have been associated with the banks becoming a dominant provider of other product areas, further concentrating UK retail banking (Which? 2013).

An emphasis on property lending

So far the analysis has focused on how pressure to deliver returns for one stakeholder, the shareholder, has implications for other groups – customers and employees - through cross-selling and cost reduction measures. A wider view of the critical business model impacts could also consider changes in lending practices where banks have failed to meet government expectations about lending to business (especially SMEs) as a way of promoting business investment and growth. Instead, UK retail banks have focused on property lending, with revenues from the mortgage market exceeding £15bn in 2011, or more than 35% of total revenue. This is significantly higher than in other European retail markets: Germany 15%; France 18%, Italy 9% and Spain 22% (The Treasury Committee 2011). Figure 7 shows that banks were the key driver of the expansion of mortgage lending: by the end of 2012, banks held 69% of balances outstanding, equivalent to almost a doubling of assets to £873bn (from £468bn in 2002) within a decade. Growth in mortgage books is partly a consequence of the simplicity of the lending decisions, in comparison with SME lending. The introduction of centralised credit-scoring systems minimise the costs and expertise required for mortgage approvals and this, in turn, has allowed mortgage approvals to be mechanised based on limited and easily obtainable information – the borrower’s income, credit history and the property’s market value.

INSERT FIGURE 7 ABOUT HERE

The seizure in the mortgage market in 2007 increased the spreads between base rate and annual interest payable on various mortgage products significantly from pre-crisis values; as figure 8 shows, spreads increase from around 2 to 4 percentage points, making post-crisis mortgage lending more lucrative. This development can be partially explained by the re-pricing of mortgage risk after the financial crisis, but it equally highlights failing competition because lenders’ ability to issue new mortgages is constrained by the increased cost of capital and demand for higher capital ratios, especially for building societies.

INSERT FIGURE 8 ABOUT HERE

UK banks’ preference for lending on residential property, coupled with the reduction in the branch network, does little to help foster good relations with SMEs, a matter of longstanding concern to business organisations and government. While further analysis of lending practices is beyond the

scope of this paper, it is sufficient to note that the business model pursued across the retail banking sector also has wider implications beyond the market for personal current accounts, given the (potential) economic significance of banks.

Overall, the critical business model framing illustrated above goes beyond conceptualising a market in micro-economic terms; instead it considers a range of stakeholder interests and how the pursuit of a financially viable outcome for the business will differently reflect the expectations and interests of particular groups. More explicitly, in a financialized context, credibility with shareholders, measured through metrics like RoE, are achieved by cost management, opacity and revenue enhancing actions that affect the interests of other stakeholders. If the critical business model framing offers useful insights, what are the implications for reform? The concluding section explores how critical business model analysis suggests a more radical policy response.

5. Conclusion: reframing and political action

This paper has shown how the reframing of retail banking can affect what is visible and open to debate. The point is not to simply replace one frame with another, but to open up alternative ways of looking at problems and to find points of intervention so that the field of stakeholder interests is cranked open. The dominant framing of the UK retail banking sector as being insufficiently competitive clearly points to key features of the market, namely, concentration and the unwillingness or inability of customers to change their provider. The reframing of retail banking does not mean that these features are irrelevant; rather it puts them into a context which offers a different interrogation of the problem. Thus, it is not simply that the UK industry is highly concentrated. Rather, the monoculture of shareholder-owned banks encourages mimetic behaviours intended to improve return on equity, but these create the conditions for opacity, mis-selling and a business model overly-dependent on property lending. Tackling this is likely to require not a more competitive market but a different conception of the purpose of banking and of stakeholder interests; and a willingness to keep a utility service out of the realm of financialization. In this respect, introducing critical business model analysis into the debate about banking reform puts into practice the calls by Willmott (2012) and others for knowledge that can make contributions to debates about public interest.

The reform of retail banking requires political support and there are many reasons to be cautious about the possibilities for change, given the interests around banking and finance (Engelen *et al.* 2011). Writing on a related problem, the reform of finance as a discipline in the wake of the global financial crisis, Gendron and Smith-Lacroix (2015) argue that despite high stakes and the possibility of paradigmatic diversity, mainstream thinking continues to resist change. This can be seen as part of a wider resilience of global finance within a form of neoliberal capitalism that has been reinvigorated by the crisis rather than stopped in its tracks (Chabrak and Gendron 2015). To understand why, in a specific instance such as UK retail banking, the political appetite for reform has been so weak, the concept of framing is helpful. As Entman (1993) notes (using the illustration of debate that took place in the US before the first Iraq war) moving debate outside the established frame can be difficult because it requires a challenge to 'the bounds of acceptable discourse' (p.55). A 'tacit consensus' between elites serves to limit the options that can be discussed: in this case, the tacit consent relates to the suitability of shareholder value driven business models in the provision of utility retail banking services. Pressure to sustain (or deliver higher) shareholder returns leads to

near-continuous attempts to reduce costs and increase revenues. While banks deploy differentiated marketing and other policies, the underlying business model has much in common: as a consequence, customers have limited choice between banks whose mimetic models are characterised by opacity, confusion, cross-subsidy and cross-selling (including mis-selling).

If the underlying problem is the expectations of shareholders, interpreted as rate of return targets, an obvious response is to directly challenge the dominance of financialized business models. However, while there are significant pockets of dissent about the ideology of shareholder value, which variously challenge the legal basis for shareholder primacy and the practices of financialized firms focused on share price or other short-term indicators (see for example Stout 2012; Martin 2011), these remain non-mainstream views. Any major shift in corporate behaviour is likely to be slow as shareholder value is so entrenched. A pragmatic response could be to move some banking activity outside of the domain of shareholder value on the basis that access to basic banking services is a pre-requisite for social and economic participation for citizens, just as business customers require supportive banks. Different kinds of ownership and governance could allow stakeholder interests to be rearranged and outcomes to be less detrimental to bank customers.

The most obvious implication of shifting from a competition to a critical business model framing is to challenge the assumption that having more banks would necessarily improve choice and outcomes for customers. If the sectoral model is mimetic, in that the players copy each other's moves and there is relatively little to distinguish between them, adding more players will make little difference to customers. However, a competition *between* business models would be more significant. This might include banks with a more distinctive regional or local identity, banks that were part of other organisations, like the Post Office, or a revival of mutuals. To be significant, such alternatives need to have scale and political support. However, new business models could also be made distinctive by creating and supporting banks serving a wider set of interests. Building capacity and expertise in local business lending would be a distinctive approach for regionally-based banks; or, creating links between the savings of citizens and the need for social investment in local and regional projects so that savings are not simply channelled into the housing market but are put to a more socially-productive use. Developing these or other ideas is a significant and complex task that requires a political and organisational commitment to changing business models.

Even without a significant improvement in the choice of retail banks, there are certainly areas where retail banking model changes would create customer benefits. For example, transparency about the cost of bank accounts could be promoted through an explicit statement about charges and an unbundling of services so consumers can choose which services they require (and understand what charges they will pay). Regressive cross-subsidy would be avoided, so that overdrafts are not an opportunity to charge very high fees to subsidise in-credit customers. Fees and charges could reflect costs to the banks of providing basic banking services (deposits, savings and transactions), with the provision of simple accounts at low charges for those who wanted them. More radically, banks could be required to adopt a progressive charging principle that allowed lower (or nil) fees on accounts for those with lower balances; or higher interest rates could be offered to those with small amounts of savings. Such decisions clearly reflect the social importance of banking: critical business model analysis opens up a space for debate about retail banking and requires a more proactive role from regulators. In this way, the paper may serve as a platform to demonstrate the limitations of neoliberal, competition focused approaches to business model analysis and neoliberal regulatory oversight.

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Appendix A

Abbreviations

BSA	Building Societies Association
CMA	Competition & Market Authority
EFRAG	European Financial Reporting Group
FCA	Financial Conduct Authority
FiiC	Free-if-in-Credit account
FSA	Financial Services Authority
ICAEW	Institute of Chartered Accountants, England and Wales
ICB	Independent Commission on Banking
IIRC	International Integrated Reporting Council
IT	Information Technology
M&A	Mergers & acquisitions
NCI	Net credit interest
OFT	Office of Fair Trading
PCA	Personal current account
PPI	Payment Protection Insurance
RBS	Royal Bank of Scotland
RoE	Return on equity
SME	Small & medium-sized enterprise
UK	United Kingdom

Figure 1: Competition Cycles in UK retail banking

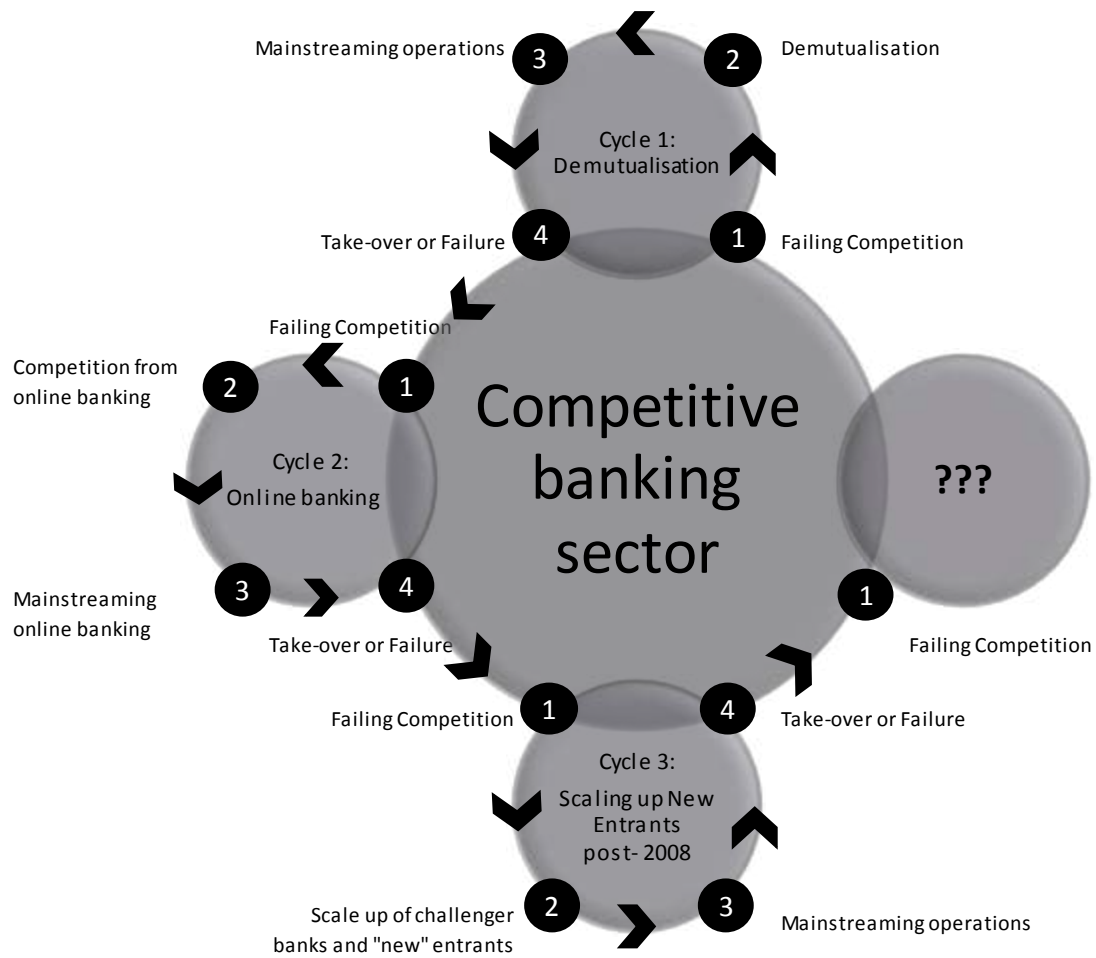
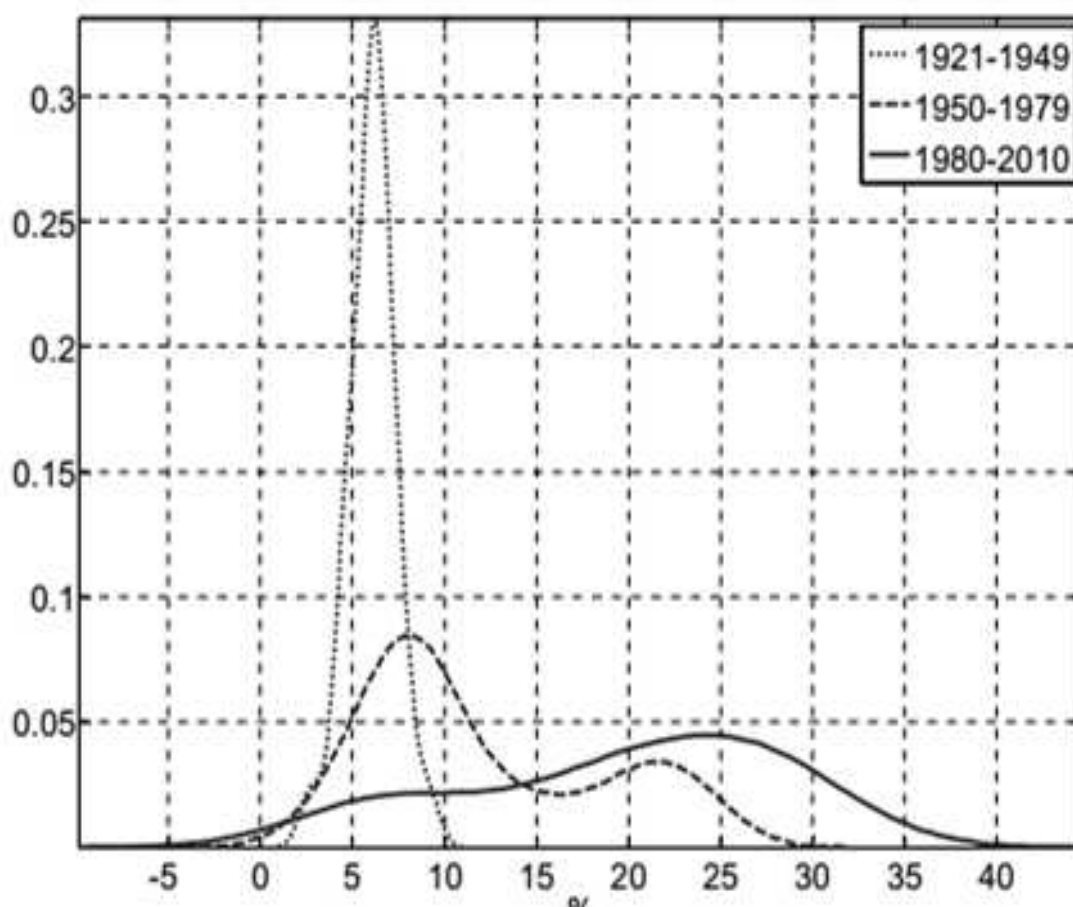


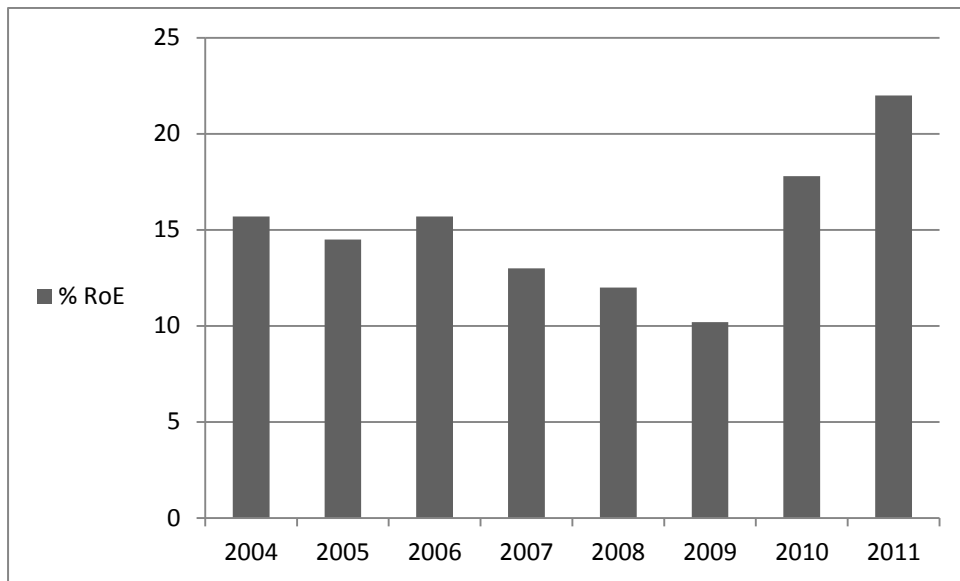
Figure 2: Estimated distribution of UK banks' return on equity (RoE), 1921-2010



Source: Haldane (2011), based on Capie & Billings (2004), BBA and BoE calculations.

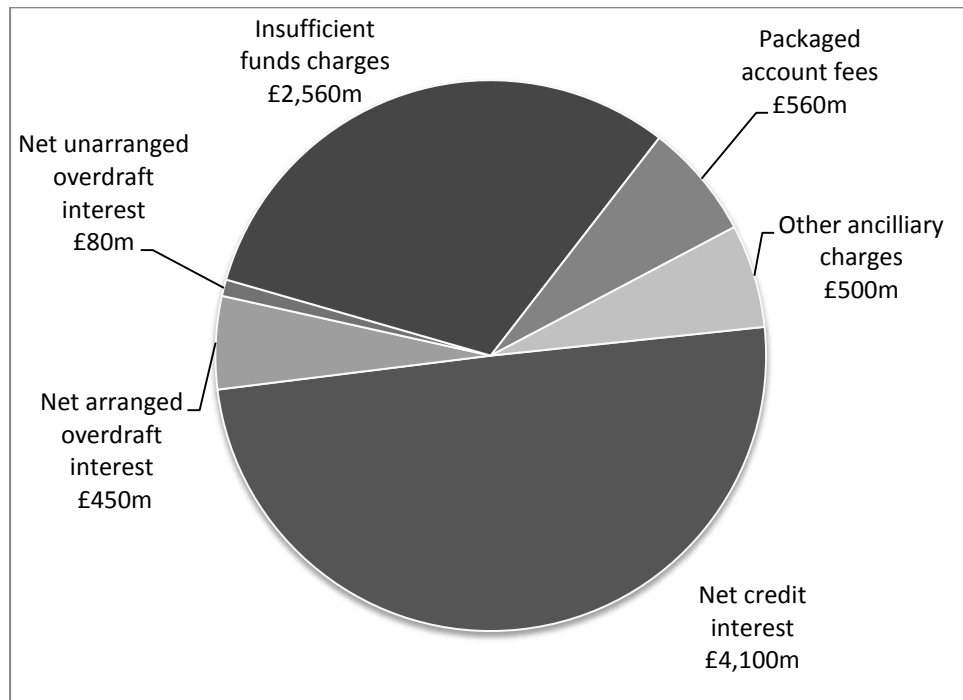
Note: The vertical axis shows the distribution of the observations as a fraction of 1 for each subsample, i.e. 0.05 = 5% of firms in that period; the horizontal axis illustrates RoE in %, e.g. '5' equals a 5% RoE. For each period, annual RoE observations for banks were collected. This data was then used to model the distribution (using a non-parametric kernel density distribution, a little like a smoothed histogram). The distribution shows that, for the period 1921-1949, over 30% (shown as 0.3 on the vertical axis) of observations had a return of around 6% (shown on the horizontal-axis); between 1980 and 2010, most observations (0.05, or 5%) were at a level of 20% (or more) RoE. The distribution also becomes much wider, indicating a larger spread of RoE across the observations across banks over that time period.

Figure 3: Average UK retail banking return on equity (RoE), 2004-11



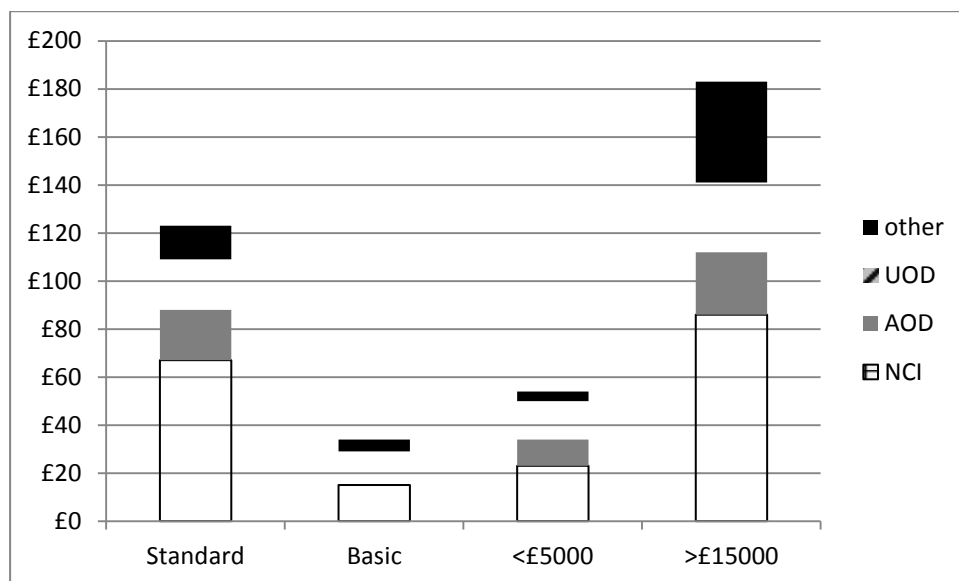
Source: Quarry *et al.* (2010)

Figure 4: Break-down of personal current account (PCA) revenue, 2006



Source: OFT

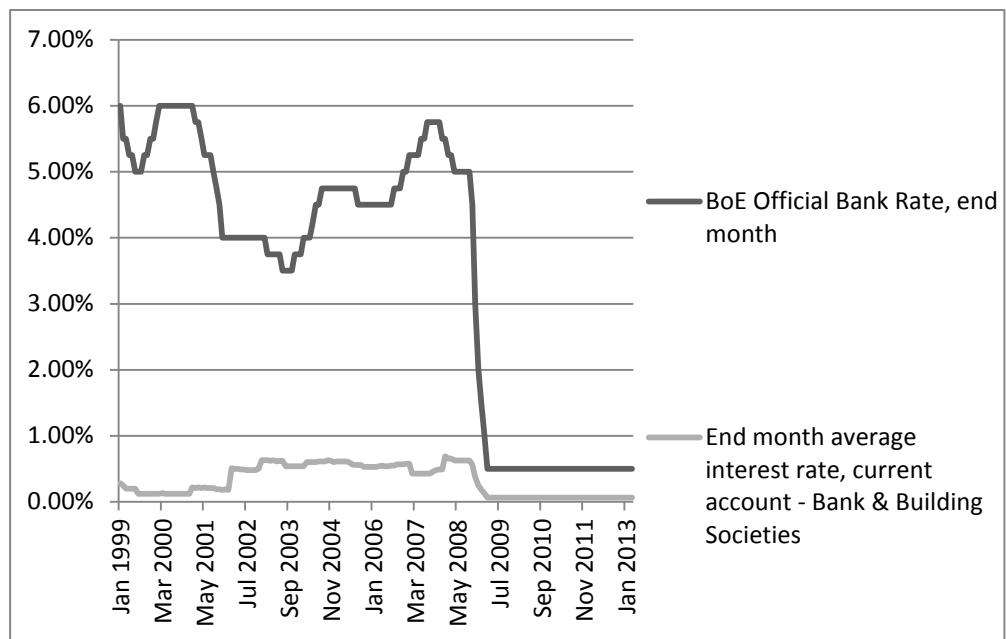
Figure 5: Average revenue derived from personal current accounts (PCAs), by type (2011)



Source: OFT (2013), derived from Tables 3.3 and Figure 3.2

Note: UOD = unarranged overdraft; AOD = arranged overdraft; NCI = net credit interest. 'Basic' bank accounts provide limited services for customers with poor credit rating; 'standard' represents a full service free-if-in-credit current account. <£5,000 and >£15,000 refers to the average net balance on the PCA.

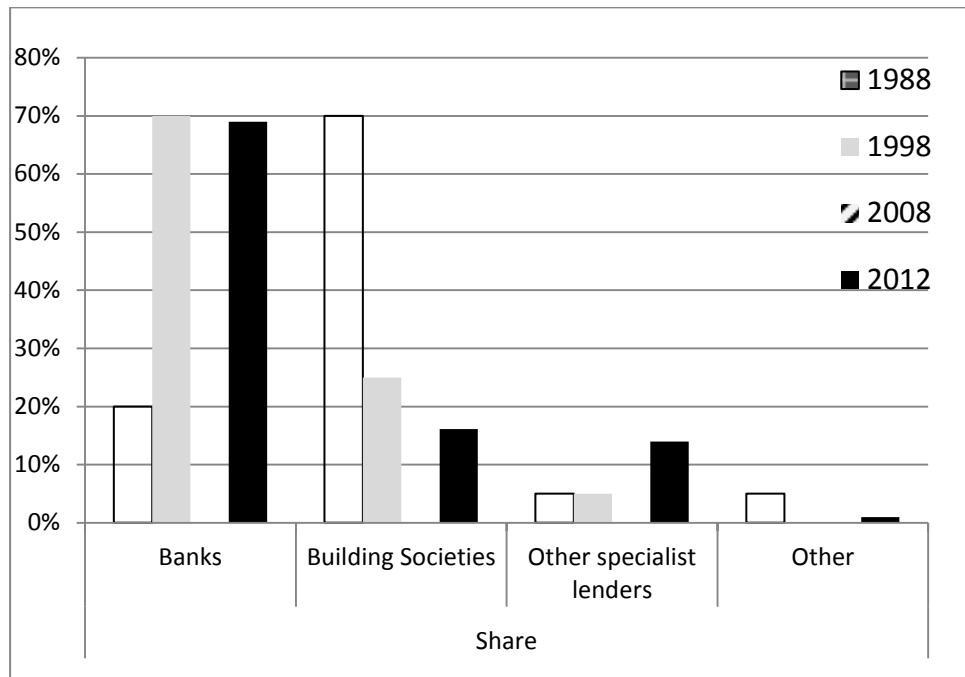
Figure 6: Comparison of interest rate paid on PCA with the Bank of England official bank rate (OBR)



Source: BoE data

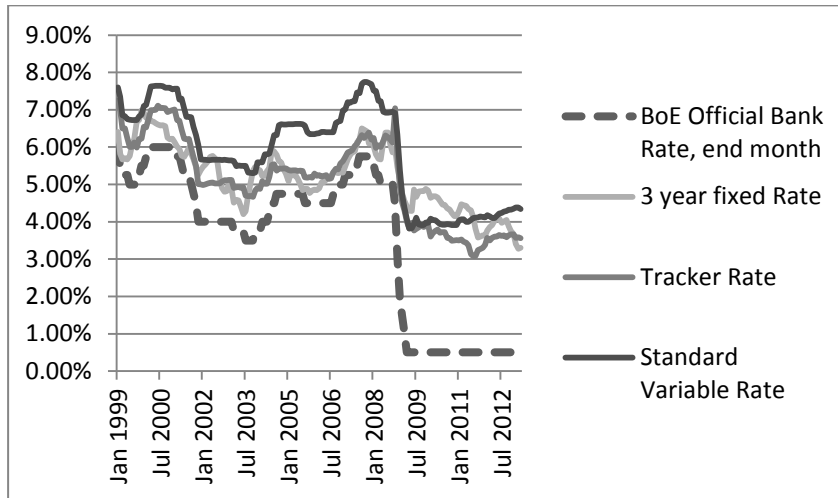
Note: BoE discontinued publishing this dataset in Dec 2007; 2008-2013 figures are calculated using the average of monthly 'End month average interest rate, current account - Bank & Building Societies'

Figure 7: Mortgage balances outstanding: share of mortgage balances held by banks, building societies and other lenders, for selected years



Source: BSA, BoE

Figure 8: Mortgage interest rate spread, 1999-2012



Source: BSA

Notes

¹ Mis-selling is a term commonly used to describe the practice by banks or other financial intermediaries to advise the consumers to purchase a product or a service that is not suitable to be sold to this specific consumer or ignore guidelines such as 'know your customer obligations'; see <http://www.fsa.gov.uk/library/communication/pr/2003/052.shtml> for more information

² *Financialization* describes the process whereby financial markets, institutions and elites increase their influence on economic activity vis-à-vis firms increasingly employ financial motives to guide and justify their behaviour, in particular employing shareholder value principles at the heart of corporate strategy and decision-making processes (Froud et al 2006).

³ Following the financial crisis approval for banks has sunk to an all-time low of 19% (compared to 63 in 1994 and 91% in 1987; NatCent 2010: p. 142) – this finding is seconded by a number of additional publications, including YouGov (2013) and Which? (2012)

⁴ For details, see <http://www.uswitch.com/media-centre/2015/09/big-banks-fall-from-grace-in-customer-satisfaction-stakes-while-new-entrants-continue-to-shine/>.

⁵ PPI is an insurance product that insures that loans or debts are repaid in case of certain events, such as illness, death or unemployment. The controversy lies in the fact that consumers have been sold this insurance product without prior knowledge, i.e. as part of a loan, mortgage or credit card they took out; or, that exclusion clauses within the insurance product disqualify claimants from receiving coverage, such that a consumer would not have purchased the product had they understood its character. For more information, see <http://www.financial-ombudsman.org.uk/publications/factsheets/payment-protection-insurance.pdf>

⁶ As explored in the critical business model analysis, the relevant categories of worth focus on financial returns (principally the return on equity) and hence reflect the significance of the shareholder interests in the business model (despite marketing emphasis on customers).

⁷ 'Big Bang' describes the sudden and far-reaching deregulation of the financial markets in the UK in 1986, making it one of the most globally competitive financial centres. Apart from the substantial transformation of the structural character of the city, from narrow professions to financial conglomerates offering a hugely expanded, almost universal, product line; the culture in the City post-'Big Bang' shifted from a long-term-focused gentlemanly club towards a short-term, profit dominated playing field where regulation is considered an opportunity for bricolage; see Engelen et al (2011)

⁸ Building societies are customer-owned financial intermediaries with a traditional focus on savings and home loan products and they were the dominant players in the residential mortgage market until 1989 with a collective market share of 70% - See data in Figure 7.

⁹ TSB and C&G by Lloyds in 1995 and 1997; Halifax by Bank of Scotland in 2001; The Woolwich by Barclays in 2000

¹⁰ For example, HSBC and Midland Bank in 1992; Natwest and Royal Bank of Scotland (RBS) in 2000.

¹¹ The index indicates changes to diversity in the financial markets based on four components: size and number of firms in the market; ownership; funding and resilience & geographic location. The findings illustrate that financial services in the UK became less diverse since the financial crisis; thus highlighting how current policy initiatives fail to realise ambitions to create a more diverse and resilient financial system. Moreover, it highlights how banks seeking to create shareholder value have further increased their market share in UK financial services.

¹² 'Challenger' banks was a term introduced after demutualisation to emphasise the role smaller new banks supposedly played in competing with larger traditional banks (also referred to as 'incumbents'). For more detail see, for example, <http://www.bbc.co.uk/news/business-18768401>

¹³ The International Integrated Reporting Council (IIRC) defines itself as 'an international cross-section of leaders from the corporate, investment, accounting, securities, regulatory, academic, civil society and standard-setting sectors' (2013).

¹⁴ See, for example, Johnson *et al.* (2008) on Gillette or Brea-Solis *et al.* (2015) on Walmart

¹⁵ The analysis draws on reports by regulatory authorities, Parliamentary committees, investment analysts and consultancies.

¹⁶ The exhibit illustrates long-term trends of RoE in UK banking during particular periods. For each period, annual RoE observations for banks were collected; this data was then used to model the distribution, for example, for the period 1921-1949, over 30% (shown as 0.3 on the vertical axis) of observations had a return

of just above 5% (shown as 5 on the horizontal-axis); between 1980 and 2010, most observations (0.05, or 5%) were around 20% RoE, with the curve distribution much wider, indicating a larger spread of RoE across the observations across banks over that time period.

¹⁷ The difference in this figure and those depicted in Figure 2 is that Figure 3 focuses on retail banking only for specific years; whereas Figure 2 depicts longer term trends during particular periods for banks (not just retail banks)

¹⁸ Even if we control for urbanisation by multiplying the number of branches per million with the urbanisation rate (using OECD NUTS 3 methodology 'predominantly urban'), the UK values (139) are considerable lower than for other main markets (Germany 278; France 208; Italy 291 & Spain 453 and the EU-27 206 which suggest that the effect is not only explained by people living in cities.

¹⁹ The overall scale of job loss in banking is significant with some 132,000 jobs cut in the four years since 2008, according to the Economist Intelligence Unit 2013. Not all of these are in retail banking but the sector has borne the brunt of a significant part of overall downsizing in banks.

²⁰ Core Retail Banking Products include: instant access savings, current accounts, credit cards and overdrafts, personal loans, mortgages & time deposits.

²¹ PCAs are a form of transaction account held by a bank for a customer enabling customers frequent and immediate access. For more information and background information on PCAs please refer to OFT (2013) page 11ff

²² PCAs generate between £18 for a student account and £300 for a packaged account The Treasury Committee (2011). Ninth Report: Competition and Choice in Retail Banking. London: HM Treasury.

²³ More recent figures show that the revenue per account has fallen to £125 by 2011, largely because of a drop in net credit interest as wholesale interest rates have fallen, thus reducing spreads (CMA 2014b, pp.121-2).

²⁴ Record-low BoE base rates of 0.5% limit NIC earning potential as spreads have collapsed.

²⁵ Indeed the banks are now being asked to respond to complaints about mis-selling of packaged current accounts, starting another cycle of large provisions and compensation payments. According to the *Guardian*, by mid-2015 customer complaints had reached 1,000 per week (Jones 2015).