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ANALYSIS OF COMPETITIVENESS AND EFFICIENCY OF
BANKING SECTOR IN FINLAND

Bachelor Thesis

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Tallinn 2017

I declare I have written the bachelor thesis independently. All work and major viewpoints of the other authors, data from other sources of literature and elsewhere used for writing this paper have been referenced.

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ABSTRACT

The topic is analysis of competitiveness and efficiency of banking sector in Finland: case Osuuspankki.

The topic is concerning the Finnish banking and the objective is to find analysis of the Finnish banking's competitiveness situation and efficiency. The thesis works as an overview of Finnish banking sector and it also can be utilized as a tool to define how the Finnish banking is currently and how it is changing.

The specific problem contains information on how Finnish banks compete and how they maintain efficiency.

The method of research is to find relevant theoretical information about the topic and then to make expert interview to find out more information to confirm the theory and find out new information.

The content and the references of the theory are provided mostly by recommendations of the professionals from the banking sector in Finland.

The interview was done with a professional of Finnish banking sector and specifically from Osuuspankki; Service Manager Lauri Tammenniemi, which is also part of the main bank what is observed mainly in this thesis.

Keywords: Finnish banking, bank competitiveness, bank efficiency, technology, retail banks, Osuuspankki, innovation

INTRODUCTION

The topic was chosen due to the reason that Finnish banking sector is unique in a sense that most of the bank in Finland or Nordic subsidiaries and the banking operates with Finnish frames. Also, banking sector can be described as one of the most fundamental institutions that is. Huge parts of peoples' everyday life have to do with banking and that is why it is vital to observe.

The topic is relevant because the world of banking is in continuous change and the competition and internal efficiency must be analysed consistently. There are a lot of literature relevant to this topic which supports the idea that it is fundamental.

Banking sector today faces a continuous change along with the technological development. It requires banks to be constantly active to maintain their position in the markets. It also provides opportunities to obtain new ideas and developments to efficiently grow against competition.

Finland is a relevantly small market in banking sector and majority of the retail banks there are either Finnish or subsidiaries of other Nordic banks. The Finnish banking has shown good results despite the weak economic situation. The growth in the economy, improvements in technology and other aspects in the future makes it interesting to observe how banks in Finland keep their operation efficient and how they maintain competitiveness against competition, either locally or internationally.

The profit of retail banks mainly comes from interest income, fees and commissions, securities and other types of income. The question is how banks should distribute profits now and in the future. How the banks can maintain competitiveness in regards of real economy and how risk is minimized but profits are maximized.

The main questions and hypotheses:

H1: The main objective is to find out what are the methods to maintain competitiveness in the banking sector?

H2: How Finnish banking maintain the efficiency in the market?

H3: The Finnish banking sector is stable enough to maintain their position and even grow further.

The expected outcomes of this Thesis are to find out how the competitiveness is currently in Finnish banking sector and what it is going to be like in the future.

This thesis uses the perspective of both academic and business practitioners. The empirical part of this thesis is based on interview with professional in this certain field. The objective of empirical part is to support the theory which will be produced with number of literature relevant to the topic.

The structure of this thesis is to firstly define Finnish banking and especially Osuuspankki, which works as an example in this thesis.

The thesis then continues with the definition of competitiveness in banking and then observations of it.

Then the final chapter before annexes is the definition on efficiency in banking and how it is defined in banking.

I. FINNISH BANKING SECTOR

The first part of the theory covers general overview of Finnish banking sector; what kind of characteristics it has, what are the volumes of it and how it operates. This part of the theory will help to get knowledge in the further parts of the theory.

This part of the theory also covers the basics of Osuuspankki which is the main bank to observe in this thesis.

1.1. General view of Finnish banking sector

In recent years despite the weak economic situation, Finnish banks have been able to maintain their results in a satisfying level. Banks have been continuing to adapt to new working conditions by for example reducing the amount of employees, offices and renewing their working models and business arrangements. The reasons for the changes in Finland and globally has been the development in technology such as electronic services, tightened regulations, weak macro-economic condition and low interest rates. (Finanssiala – pankkivuosi 2015)

In Finland there are almost 300 credit institutions and a bit over a 1000 bank offices. The largest retail banks in Finland are Osuuspankki (OP), Nordea Pankki Suomi, Danske Bank, Handelsbanken, Säästöpankit, Aktia pankki, POP pankki, Ålandsbanken. The two largest are OP and Nordea which together has market share of approximately 62% of total market share of Finnish retail banks. (Finanssiala, 2015)

1.2. Introduction of Osuuspankki

OP-ryhmä (OP-group) is the largest financial services group in Finland with market share of 36%. (Finanssiala – 2015)

OP-groups includes OP Yrityspankki Oyj, Helsingin seudun Osuuspankki, OP-Korttiyhtiö Oyj, OP-Asuntoluottopankki Oyj, OP-Prosessipalvelut Oy and Yhteenliittymäosuuspankit.

OP employs 12,000 people and have 3,9 million private customers and 440,000 corporate customers. (OP, 2016)

OP Financial Group is Finland's largest financial services group. It provides its customers with the best loyalty benefits and the most extensive and diversified range of banking, investment and insurance services. The Group has three business segments: Banking, Non-Life Insurance, and Wealth Management.

The Group consists of some 180 independent member cooperative banks and OP Cooperative which they own, including its subsidiaries and closely related companies. Group's operations are based on the cooperative principle - cooperation and sharing the fruits of success with everyone. OP's mission is to promote the sustainable prosperity, safety and wellbeing of their owner-members, customers and operating regions. Our long-term customer-centred approach also enables continuous renewal. We develop our services and products to meet our customers' needs.

The income for Osuuspankki comes mainly from three sources; banking, non-life insurance and wealth management.

Banking is the largest business segment of OP providing consumers extensive and comprehensive range of products and services. OP is the leading provider of home and corporate loans in Finland. (OP, 2016)

OP is a cooperative bank which has a central organizations and a number of cooperative banks. OP Financial Group is owned by its customers and the Group's 1,7 million owner-customers

own the OP cooperative banks. Cooperative is a different kind of form of company, it is rare form of company anywhere else than in Finland and other Nordic countries. Cooperative association means that the owners and users of it are the members.

OP practices cooperative organization due to the reason that the individual banks have a common ground. The object is to create a path for success and collectiveness through out all the banks of OP. (op.fi - osuuskuntatoiminta)

Co-operative company form is independent organization for individuals, which members are voluntarily joined to achieve economic, social and cultural objectives with the joint property. (International Co-operative Alliance, 2013)

“Well, the cooperative company form has recently being perceived as old-fashioned and country-style form of company. However, nowadays it is really trendy way to run business and many young entrepreneurs in Finland do it such way. The way for example, how Nordea does it gives them more advantage in the international markets, which they are succeeding really well with their subsidiaries around the world. OP operated differently and they are satisfied with the way their working model is functioning. They are also able to have business co-operatives in different countries but in different way than “traditional” company forms have.” (Tammenniemi, app. 4)

OP Cooperative is the central institution of the amalgamation of the cooperative banks. The cooperative’s members are the amalgamation’s deposit banks and other credit institutions. By virtue of “Laki talletuspankkien yhteenliittymästä” (Act on the Amalgamation of Deposit banks). The central institution has both the right to control its credit institutions and the obligation to supervise their operations. (OP, 2016)

1.2.1. Business segments

OP Business segments are as mentioned above; banking, non-life insurance, wealth management and product and service development.

1) Banking

Banking is the largest segment of OP. OP Banking provides for private customers; services and products include daily banking, loans, savings and investments, and housing-related services. For corporate customers OP provides financing, payment transaction and cash management services, investment services, and expert services related to business development.

Loans and deposits

(billion €)

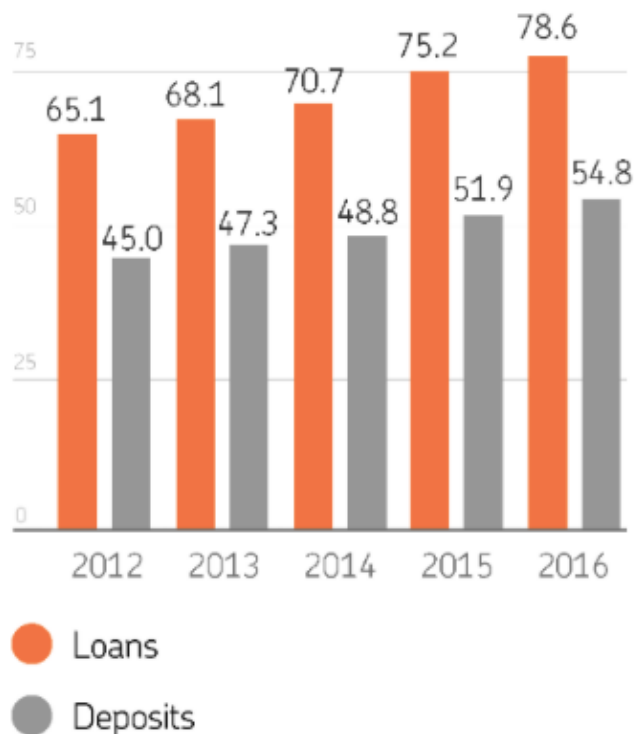


Figure 1: Banking, Loans and deposits, OP

Source: (OP year 2016, Business segments, 2017)

The chart above shows the amount of loans and deposits by OP in the years 2012 – 2016. Both figures have been increasing consistently.

2) Non-life insurance

Non-life insurance is the second segment of business of OP. OP is Finland's leading non-life insurer.

OP offers diverse range of solutions for private and corporate customers. OP has partnerships with over 20 industries, such as healthcare, car repair, building renovation etc. Expanding health and wellbeing services is well-suited to OP's responsible mission of promoting the success and prosperity of its owner-customers and operating region. (OP year 2016)

Non-life insurance

Premium revenue

(million €)

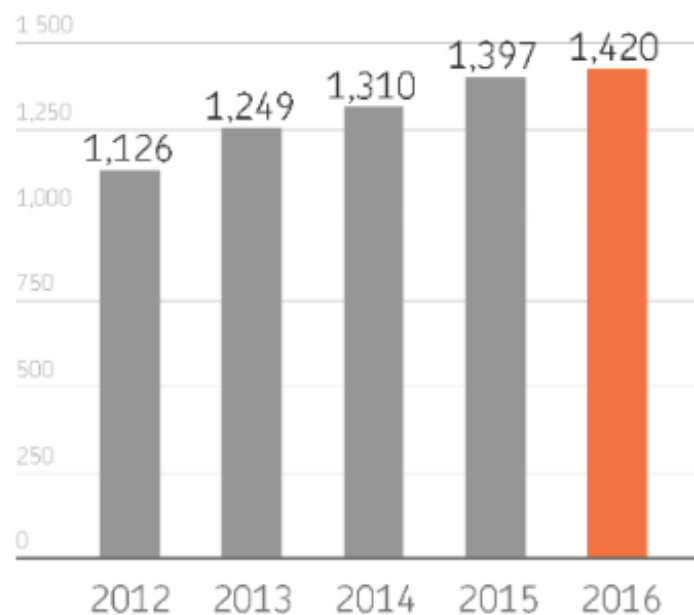


Figure 2: Non-life insurance, Premier revenue, OP

Source: (OP year 2016, Business segments, 2017)

The chart above shows the amount of premium revenue by OP in the years 2012 – 2016. The revenue has been growing consistently.

3) Wealth management

Wealth management is the third business segment of OP. OP's Wealth management is the amongst the top providers in Finland.

Assets under management

(billion €)

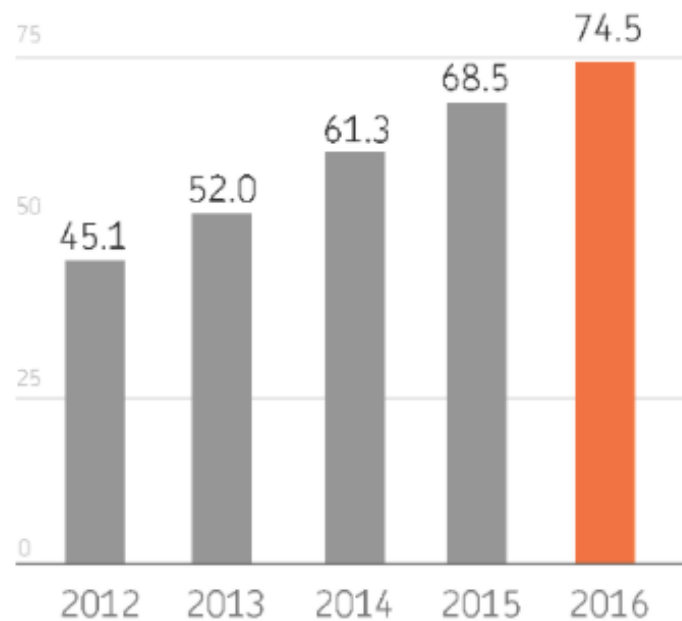


Figure 3: Wealth management, Assets under management, OP

Source: (OP year 2016, Business segments, 2017)

The chart above shows the amount of assets under management in the years 2012 – 2016. The amount has been growing consistently.

Banking and Investment Services is the largest of OP-Pohjola Group's business segments. It covers the asset management, lending and payment services for both private and corporate customers.

OP Pohjola Group's extensive range of life insurance products includes pension policies, savings and unit-linked policies as well as term life insurance and capital redemption contracts for companies.

OP-Pohjola Group provides extensive nonlife insurance coverage for both private and corporate customers. The main policies for private customers include household and motor liability policies and accident, medical expenses and travel policies, while all statutory and voluntary policies as well as extensive risk management services are available for corporate customers.

“The mayor parts of the operations of OP are banking, insurance and asset and financial management. Also nowadays the new operational part is the matrixes; digital operations which are constantly under development.” says Tammenniemi.

The new operational part of the OP is the digital development with the cooperation with other companies; larger groups such as Fortum and also start-ups.

“It is impossible to be competitive without new operational aspects of banking. Also companies are required to make profit no matter what, what is the reason why banks and OP has to develop constantly.” (Tammenniemi, app. 5)

The new operations consist of hospitals, electric-car industry and many more innovative aspects.

1.2.2. History of Osuuspankki

OP has throughout its history been developing their operation in terms of Finnish identity. The whole company has roots in Finland and nowadays still enhances the Finnish national identity.

Highlights of the 100 year of OP;

- OP started its operations in 1902 as they started a central borrowing fund. The actual corporation was registered on 14 of May 1902. The actual daily operation started to function in 1903.
- On 1912, Pohjola (part of today's OP) joined Helsinki Stock Exchange which was being established.
- On 1928, the central association was founded with the aim of acting in rural areas and to link the cooperative funds together.
- On 1989, OKO bank becomes a listed company with around 60,000 new shareholders as it organises initial public offering and lists its shares in Helsinki Stock Exchange.
- On 1991, Pohjola opened a subsidiary non-life insurance company in Estonia.
- On 1996, OP was the Europe's first and the 2nd in the world to provide online banking services.
- On 2007, OP merges with Pohjola to become OP-Pohjola.

(OP – HISTORY)

In the year 1970, the organization of Osuuspankki got permission by law to transform into official banks. Osuuspankki was also earlier referring themselves as bank, which was a disturbing matter for the competitors.

At that stage, Osuuspankki also crossed their main point of branding which was to design the logo which is used even today. The logo was a bright orange and it was remarkable improvement from the old green ‘‘boring’’ logo that Osuuspankki used to have.

The banking status gave Osuuspankki a lot of new energy for development of the organization. The whole organization felt more important as they have gained status of official bank. (Koulumies, 2016, p. 54)

The improvements that Osuuspankki made in the years that they gained their status of banking reflects on today’s organizational behaviour as it was really trying to gain originality and differentiation from the other banks operating in Finland. (Koulumies, 2016, p. 55)

The banking laws in Finland required Osuuspankki to have to gain their financial solidity into a required level in a ten years, so until the year of 1980.

At the time, financial solidity as a financial aspect was not kept as important factor. The solidity ratios did not at first meet the requirements because it was not kept as important. The matter was not about not caring or making things unwisely but the fact was that the matter was so new that the bank did not find importance to manage with it. (Koulumies, 2016, p. 56)

1.2.3. Financial analysis of Osuuspankki

Financial analysis helps to understand the outline of the whole concept of banking in Finland. What kind of business model it is and what are the highlight points of the business.

Key figures and financial ratios;

(million €)

year 2016 – year 2015 – change

Key income statement items:

- Net interest income – 1,058 – 1,026 – 3.2
- Net insurance income – 558 – 528 – 6.0
- Net commission and fees – 859 – 855 – 0.5
- Personnel costs – 762 – 781 – -2.4
- Other expenses – 806 – 739 – 9.0
- **Earnings before taxes – 1,138 – 1,101 – 3.3**

Key balance sheet items – assets:

- Cash and cash equivalents – 9,471 – 8,619 – 8.52
- Derivative contracts – 4,732 – 5,072 – -3.5
- Receivables from customers – 78,604 – 75,192 – 34.12
- Investment assets – 25,105 – 20,784 – 43.21
- **Total assets – 133,747 – 124,455 – 92.92**

Key balance sheet items – liabilities and equity

- Liabilities to credit institutions – 4,669 -1,673 – 29.96
- Liabilities to customers – 60,077 – 58,220 – 18.57
- Debt securities issued to public – 28,287 – 27,706 – 5.81
- **Total liabilities and equity capital – 133,747 – 124,445 – 92.92**

Figures and ratios

- Return on equity (ROE) % - 9,4 – 10,3 – -0,9
- Return on assets (ROA) % - 0,7 – 0,7 – 0
- Cost/income ratio % - 52 – 53 – -1
- Capital adequacy ratio % - 23,1 – 22,9 – 0,2

(OP year 2016 – financial statements)

The figures and ratios shows that OP has been able to increase their income in all of their main sectors of business. Although their personnel costs have decreased, their overall expenses have been increasing. The EBT has grown by 3.3.

The total assets, liabilities and equity has increased significantly. The major key is the increase in cash and equivalents which has increased from 8,619 million to 9,471 million.

Overall their financial statements shows that OP has had a healthy growth, which enables the company to expand into new fields of businesses. They state in their financial report that they have been able to improve their indicators although the financial growth in the world has been slow.

In 2016, OP has gained 160,000 new OP Financial Group banking customers and 260,000 new owner-customers. The new banking customers figure is 21% more than a year ago and the new owner-customers have been increased to total of 1,7 million. The joint figure of non-life insurance and banking customers has increased to total of 1,7 million.

(OP year 2016 - financial statement)

1.3. Introduction of other banks

The two other largest retail banks or financial institutions in Finland are Nordea and Danske Bank.

1.3.1. Nordea

Nordea is the second largest financial institution after OP in Finland. Nordea is the largest financial institution in the Nordics and the headquarter is located in Stockholm, Sweden. The business areas of Nordea are personal banking, commercial and business banking, wholesale banking, wealth management and group corporate centre. (Nordea year 2016, p. 4, 10)

Nordea has been founded as a result of combining banks in the Nordic area, including Finland, Sweden, Norway and Denmark. Finnish bank Merita was the bank operating in Finland which was combined as a larger institution. (Nordea year 2016, p. 6)

Nowadays Nordea is active in Finland, Denmark, Norway, Sweden, Estonia, Latvia, Lithuania, Poland and Russia. The chairman of Nordea currently is Finnish Björn Wahlroos. (Nordea year 2016)

1.3.2. Danske Bank

Danske Bank is the third largest financial institution operating in Finland. Danske Bank is Danish Bank and it was founded in the late 1900' century. In the 1990's Danske Bank was expanded to the other Nordic countries. Until 2012 Danske Bank was known as Sampo Pankki in Finland. (Danske Bank – annual report)

Danske bank has over 5 million customers and it operates in 15 countries. The chairman of Danske Bank is Ole Andersen. (Danske Bank – annual report)

1.4. Conclusion

Finnish banks and especially OP is well defined financial group, which operates in many financial sectors. OP, for example has financial services in insurance, asset and finance management and the original banking with their developed services.

OP has been able to grow their business over the past two years, which is healthy sign for the company and overall for the Finnish banking.

2. THE COMPETITIVENESS OF BANKING

The second part of the theory covers the knowledge of how the competition and competitiveness is currently in the field of banking and especially in Finland. This part of the theory will be the main basis for the empirical part of the thesis.

2.1. What is competition in banking?

The competitiveness of banking varies on different reasons. Banking is an industry where the competition is being placed in many different levels as banks nowadays has a lot of different aspects in their business models. Banking as other fields is being under constant development which makes the competition much tighter and fierce.

The whole finance sector is changing as the technological development goes forward. New models of services are changing the logics and strategies of the businesses and the demand of customers is constantly going to a new level. (finanssiala.fi)

2.2. Osuuspankki competitiveness

OP is diversifying their services widely, especially with digitalization. OP aims gradually to change from a plain financial services provider to a diversified services company of the digital era with strong financial expertise. (OP, 2016)

OP has always been an innovative organization. They were the first in Europe and second in the world to provide online banking services. (OP, 2016)

The technological aspects of the company are highly valued and the organization is still trying to develop new ideas and innovations in the markets.

“OP has been investing in new innovation really heavily; approximately with 2 billions euros. The new already existing innovations has been transporting innovation, for example car business which is done in co-operation with Fortum. They are planning to build many new recharge stations in Finland and be part of the development of electric cars and their functions. The electric cars, for example are being rented to customers for short periods of time. OP has also been very active with hospital business and OP already has hospitals in the cities of Helsinki, Oulu and Tampere, all in Finland and in Turku there are development process for the hospital going on. The hospital business for bank and especially OP is perfect as OP has insurance operations which can be directly connected with OP hospitals. The focus of the hospitals is to be able to offer quick health services, for example for workers. The hospitals of OP are now focused on long-term illnesses and really hard medical operations but rather quick services for ‘smaller’ injuries. Also the hospital are built to be efficient with their services and quality. OP is also developing innovation in transportation, electrical payment, payment security; banking in general and not only withdrawal and deposit – actions, asset and financial management, electrical payment and not only the actual payment but the services with it, logistics in the internet services.” quotes Tammenniemi. (appendix 1.1.)

OP Lab

The OP Lab is the future of OP. OP Lab is a program of OP which is aimed to be an innovative tool to build more diversified company for the future. OP Lab contains a start-up program which is aimed to help with early-stage start-ups by working together with actual projects, solving specific problems, not making capital investments but rather getting reward from actual work and the goal is to add value to the customers with new business models and emerging technologies.

(OP Lab)

Tammenniemi says about OP Lab: “ OP Lab itself is not an operational aspect but the development that are done in OP Lab are part of the new digital operation. For example, new innovations that are being under development all over the world; even in Silicon Valley in the

United States of America where OP has its' own operational business, which are focused on new innovations.' (appendix 1.1.)

2.3. Domestic competition

Domestic Finnish financial institution or retail bank competition is based between Aktia Pankki Oyj, Danske Bank Oyj, Evil Pankki Oyj, Nordea Kiinnitysluottopankki Oyj, Nordea Pankki Suomi Oyj, Oma Säästöpankki Oyj, OP Osuuskunta, POP Pankkiliitto osk., S-Pankki Oy, Suomen Hypoteekkiyhdistys, Säästöpankki osk. and Ålandsbanken Abp.

Domestic banking figures and ratios

The section 1.2.3., OP Financial Analysis works as a basis for this section.

The total figures are combined figures of finance groups of Aktia Pankki Oyj, Danske Bank Oyj, Evil Pankki Oyj, Nordea Kiinnitysluottopankki Oyj, Nordea Pankki Suomi Oyj, Oma Säästöpankki Oyj, OP Osuuskunta, POP Pankkiliitto osk., S-Pankki Oy, Suomen Hypoteekkiyhdistys, Säästöpankki osk. and Ålandsbanken Abp.

Financial statement of Finnish Banks overall:

(million €)

2016

Key income statement items:

- 1) Total Net interest margin – 2,729
- 2) Total Income - 6,633
- 3) Total Expenses - 3,667

Key balance sheet items – assets:

- 1) Cash and cash balances - 49,504
- 2) Derivatives – 76,964
- 3) Total Assets - 466,684

Key balance sheet items – liabilities and equity:

- 1) Debt securities – 76,790
- 2) Total Liabilities and equity – 466,684

Figures and ratios:

- 1) (Total) ROA – 0,5%
- 2) (Total) ROE – 8,2%
- 3) (Total) Cost/Income ratio – 53,7%

(finanssivalvonta.fi – domestic banking sector)

When comparing the total figures and ratios to section 1.2.3. of OP, it shows that OP is domestically the one largest operator in Finland. The volumes are highest and the efficiency of business is strong.

Analysing the total market share in Finland for larger group of banks gives perspective on how OP is leading the markets and why OP is the individual bank which is fair to observe in this research

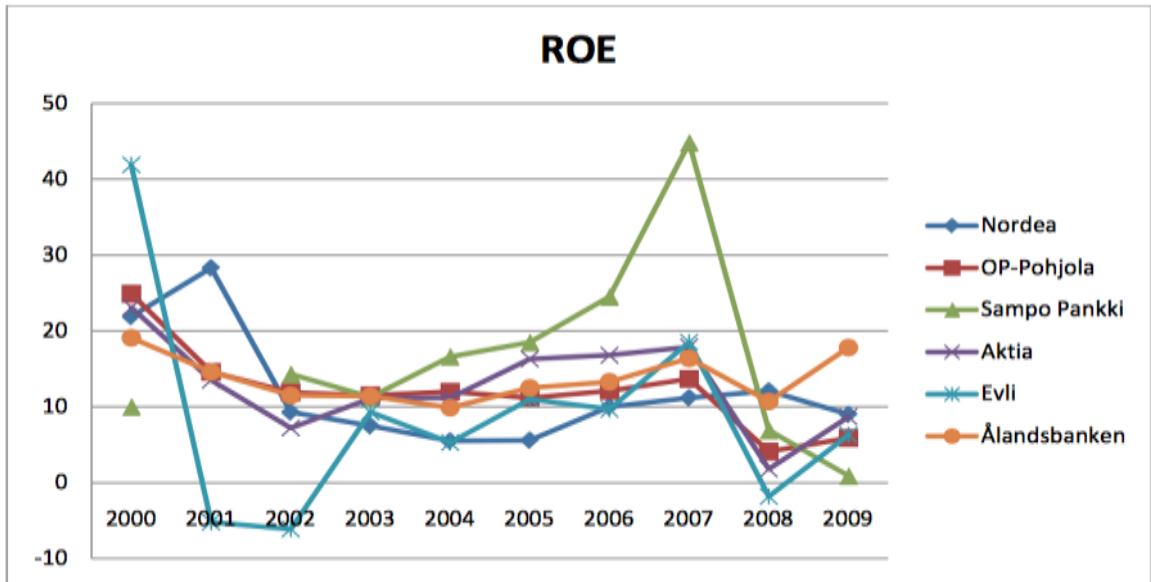


Figure 4: Return on equity (ROE) of Finnish banks

Source: (finanssivalvonta.fi – pankkien vuosikertomukset)

This measurement of profitability of Finnish banks ROE shows how Finnish retail banks have been operating in the years 2000 – 2009. The reason for the decline is because of financial crisis.

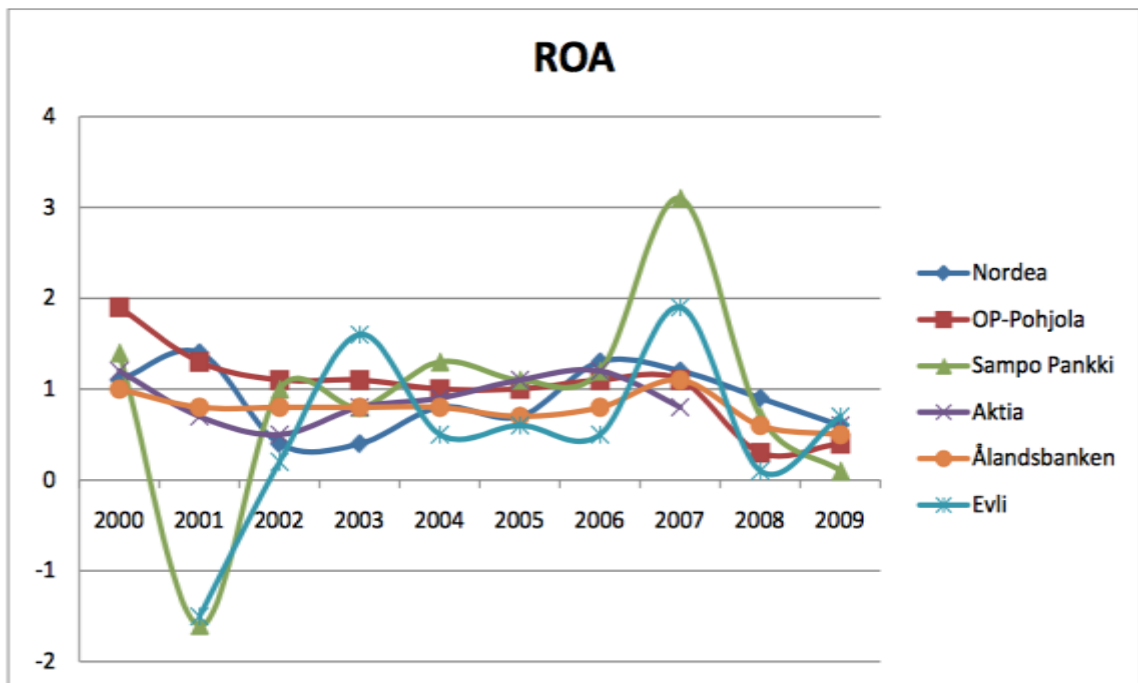


Figure 5: Return on asset (ROA) of Finnish banks

Source: (finanssivalvonta.fi – pankkien vuosikertomukset)

This measurement of profitability of Finnish banks ROA shows how Finnish retail banks have been operating in the years 2000 – 2009. The decline is because of financial crisis which larger banks were able to avoid.

Domestic banking situation

European central bank had to radically reduce the interest rates because of the financial crisis. In 2009, the interest rate had been reduced to 1%. Finnish banks were affected by the credit rates which have stayed low. (Freystätter & Mattila, 2011 p. 35-37)

The conditions of Finnish banks were also affected by new banking taxation in 2009. Banking taxation is a tax, which overall totals 170 million euros per year. Banking tax is collected for three years and the collections goes to the government's reformation budget and the money collected is planned to use to finance the joint European Union's crisis fund. This taxation method is problematic for Finnish banking sector. (Lassila, 2012 – HS)

The creditability was weakened by the new regulations for the banks. The international banking supervising committee Basel made new regulations worldwide to tighten up the banking sectors' operation worldwide. The objective was to strength the banking sectors global regulations by using the experience from the financial crisis of 2008. After the crisis in 2013 Basel introduced new regulation Basel III. The aim of Basel III was to strict the payment regulations used by banks to reduce the failures in payments of customers.

(Ministry of Finance of Finland)

The Finnish economy started to show gradual recovery. Construction grew vigorously and consumer spending grew also. Exports in Finland is still considered as weak. Unemployment took a turn downwards and inflation remained low. The housing market grew and the prices rose. The investments funds gained value in 2016 for 10% and the positive result increased the demand at the end of the year.

(OP year 2016 – financial statement)

The financial crisis has affected banking sector a lot and Tammenniemi quotes: “ Overall carefulness, the slowing business, the whole world reacts to the crisis and that makes the banking to maintain important role, the EU-directives, to government and EU makes new regulations to follow which can be really expensive for example in loaning methods. For example; the most of the loan banks can give is 90% and the percentage is really strict and has to be followed really carefully. Overall, many things have changes in the financial crisis and many things will change if they happen in the future. (Tammenniemi, app. 3.1.)

Finland is part of European Union and that makes the financial stability conjunctively weak and unstable. The independency from the international markets is from the joining European Union has been really low. However, Finnish economy has been able to protect themselves from the depression somehow... and the banks in Finland with that has been able to maintain their financial efficiency in the markets. (Taloussanommat, 2011)

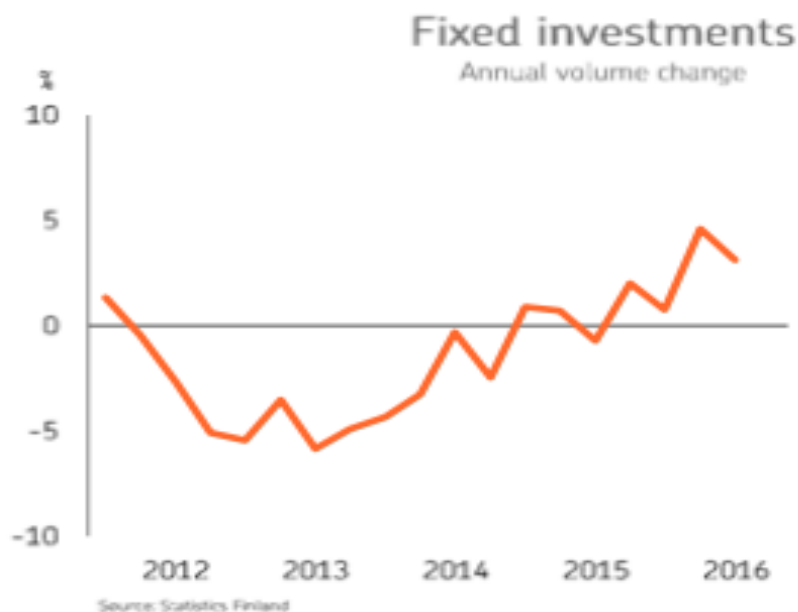


Figure 6: Fixed investments, Annual Volume Change, OP

Source: (OP year 2016, Financial Statements, 2017)

Shows how fixed investments of OP have been developing in the years 2012 – 2016. The chart shows that it has been increasing since 2013.

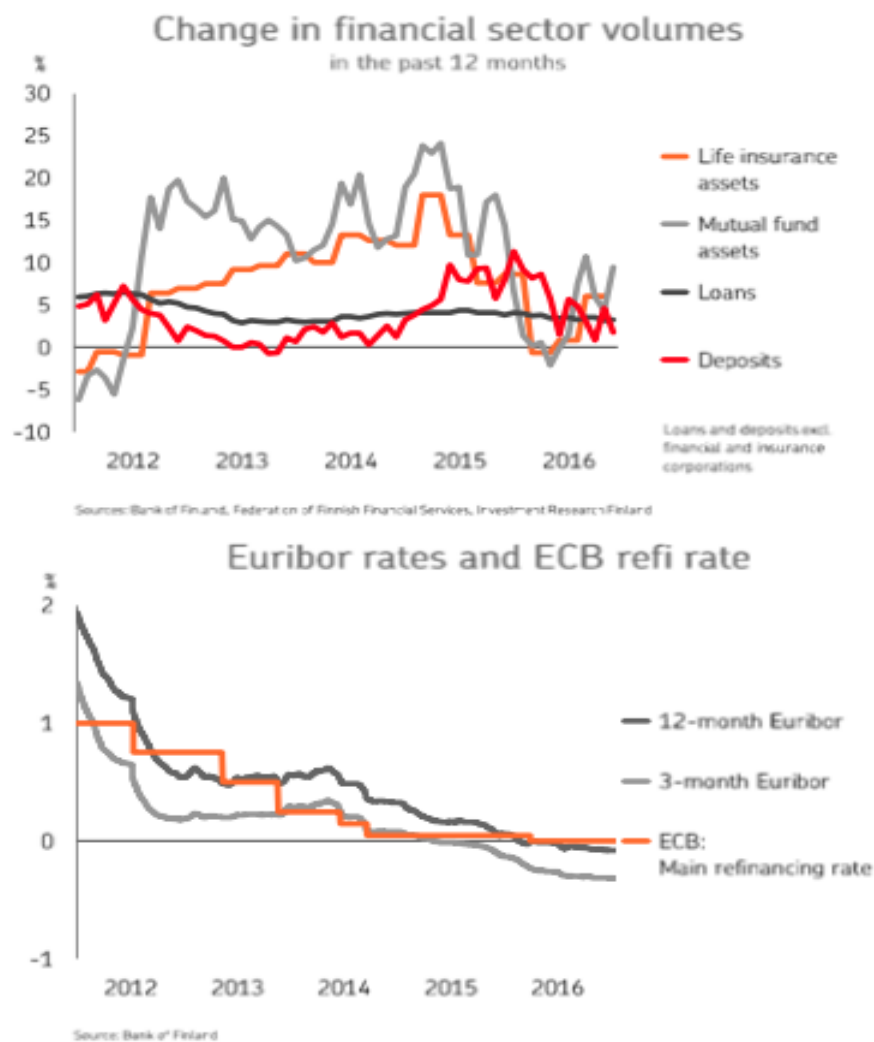


Figure 7: Change in Financial Sector Volumes and Euribor rates and ECB refi rate, OP

Source: (OP year 2016, Financial Statements, 2017)

These two charts show the changes in financial sector volumes over the years 2012 – 2016. The volumes are showing life insurance assets, mutual fund assets, loans and deposits.

The other chart shows the Euribor rates and ECB refi rate. ECB refi rate is the European central banks interest rate. The life insurance, mutual fund assets, loans and deposits are changing through the years because of the changes overall in the banking sector.

2.4. Tools of competition

Digitalization in Banking

Banking sector is one of the main sectors in business where digitalization is affecting the business models the most. Technological achievements are constantly making the banks to improve and develop their services. Digitalization, for the most part is the main tool to take advantage in the markets for the banks.

Digitalization changes the positions of competition and business environment by breaking the limits. It makes it necessary for banks to be innovative and enables them to try to break into new business models and business tools. It makes the operation of the banks quicker and more efficient and makes it easier to engage with the consumers. Digitalization enables the companies to achieve new objectives which are growth, efficiency and competition. (Ilmarinen & Koskela, 2015 p.13-14)

In Finland, most of the companies have taken digitalization as the main aspect of business. Some of the companies have been taking digitalization as a separate segment of business and few companies do not see digitalization as an opportunity for business. (Ilmarinen & Koskela, 2015 p.15)

The one most important aspect of digitalization for companies is the engagement with consumers. Companies build their business to serve the consumers better and the objective is to have a personalized consumer experience for the customers. Digitalization helps the companies to analyse and understand the needs and wants of the consumers. It helps the companies to react more quickly to changes in the markets and even predict the upcoming trends. Also it helps the organization internally to communicate between different levels and operate more efficiently. (Lindgren, 2015)

The changes in digitalization has made changes in the employment in banking, which is known of being highly employed industry in the markets. The digitalization has changed employment in banking by half in the 21st- century. Dealing with banking issues does not require anymore visits to banks, but nowadays the banking sector is highly operated online as customers can themselves work with their issues. (Kontanen, 2015 p.67)

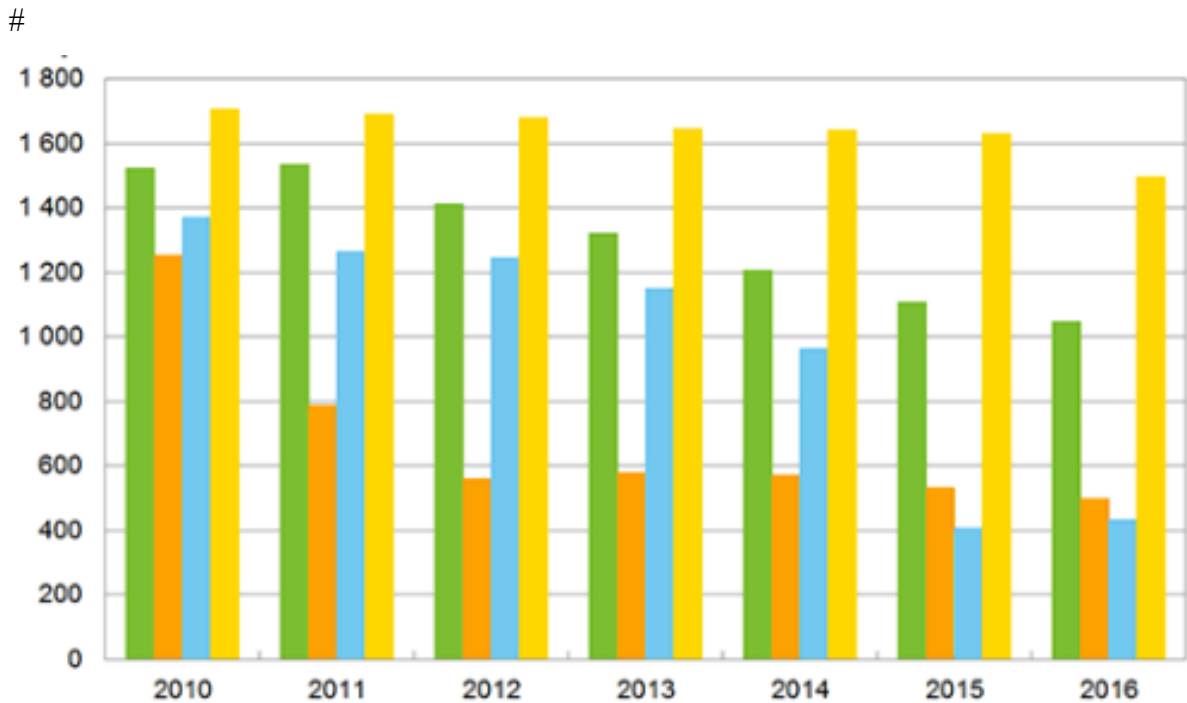


Figure 8: Changes in Banking Sector Utilities

Source: (finanssivalvonta, 2016)

The chart above shows the number of bank offices, bill payment terminals, customer terminals and ATM-machines in Finland for the years 2010-2016. The chart clearly shows the development in the technology in banking as for example the bill payment terminals have reduced hugely as the bills are nowadays paid online.

Bank office (1. Measurement each year)

Bill payment terminal / machine (2. Measurement each year)

Customer terminal (3. Measurement each year)

ATM (4. Measurement each year)

“We have been developing many new innovations to be more competitive. It is impossible to be competitive without new operational aspects of banking. Also companies are required to make profit no matter what, what is the reason why banks and OP has to develop constantly.” (Tammenniemi, app. 1.5)

The technological developments in banking sector are the new vital asset for the banks for the future and how Tammenniemi comments in the quote above that “it is impossible to be competitive without new operational aspects of banking” which means technological aspects.

The technological developments are also difficult to time correctly. Bank and companies general can not always be too early when developing new innovations. The example for that is the development of Danske Bank’s MobilePay – application, which was invented on 2014 independently by Danske Bank.

“Well Danske Bank was really the first one to make such application but the risk what always all innovations have is that you make them too early. In this case it happened as they made their own application independently are we made our application with other banks in Finland and now we have joint application which works better for larger group of consumers. Sometimes it is risky to be too quick.” (Tammenniemi, app. 1.3.2)

OP and other larger retail banks jointly invented exact application as Danske Bank and it is nowadays more profitable as it is done jointly with other banks.

“For example, mobile services; all the financial services are nowadays functioning with mobile phones. Of course also the electrical services, web-negotiations and other channels of communication. All except the traditional face-to-face communications are growing. OP in fact is the only bank in Finland which is still really focusing on traditional face-to-face communication form. OP’s web communication is actually just about 3% of all communication, when Nordea has 15% and Danske Bank has even 40%.” (Tammenniemi, app. 1.6)

2.5. Conclusion

Banking competitiveness has changed in terms of the operation of the banks and also the environment of the banking sector.

Banks have started to develop their technological aspect and it is one of the main things in highly competitive markets in banking sector.

One example of the technological aspect is the OP Lab, which is innovative tool to wider the operation of OP. Also as figure in 2.3.3.1, shows; the digitalization has changed the way banks operate with their customers.

The environment of banking is also changing quite a bit. Although OP has been able to grow naturally in recent years; they have also been struggling with regulations and financial uncertainty.

The ROA and ROE – models show that OP has been able to maintain their position in the markets, even in the times of financial crisis.

3. EFFICIENCY IN BANKING

This part of the theory covers the knowledge on the efficiency of banking. The theory covers the issues on how the banks are being efficient in the markets and how they keep themselves operating. What kind of sources of income does the banks have and what makes the business efficient in the banks.

Efficiency of the banks can be measured by their financial statements and comparison between different banks.

3.1. What is efficiency in banking?

Efficiency in the banking sector can be measured as expense-profit –relation. The banks as other business sectors have to maintain efficiency by maximizing the profits and reducing costs, with the right balance.

The efficiency measurement with banks is important to analyse due to the fact that it shows that the more efficient banks are able to make quick changes in the operation and change with the trends that are in the markets. The more inefficient banks then otherwise are more slow to make changes according to the trends that happen in the markets. (Wood, 2007 p. 31)

3.2. Measurements of efficiency

There are four ways to analyse the efficiency of banks; production, operational, profitability and intermediation.

1) Production

Uses branches to with inputs like labour and capital to operate banking and its' operations overall. This way does not accurately define the laws of banking through to the fact that the main activity of banks is not to purely provide services.

2) Operational

Measures the operations in making loans, savings, financial investments and the original banking services.

3) Profitability

Tools to analyse the banks way to use their cost factors and generate revenues.

4) Intermediation

The banking's actions when collecting funds and loans and other revenue activities.

There is no bigger-picture in measuring efficiency but rather a large scale of different kind of measurements. The overall business activity of banks can be measured of course with overall analysis of the financial statement but different retail banks have different kinds of activities and comparing them directly with each other is not an accurate way. Diversity of banking makes it hard to compare which bank is really efficient. (Eskelinen, 2014 p. 19.)

1,2) Production and operational

The first thing in operational actions in the banking is the question of variety of banking activities. Banks traditionally have large scale of different activities and in the efficiency analyses each one's quality has to be measured separately. Reliable facts about the efficiency of production and operational analysis of banks is hard and almost impossible to provide through the fact that banking sector overall is differentiated into segments such as large banks, retail banks, investment banks and banks which provides some or all of the services mentioned. Smaller banks also operated often homogeneously, which means that the operational institutions service only a certain branch of customers. (Eskelinen, 2014 p. 20)

3) Profitability

Profitability efficiency is divided into two types of measurements; profitability efficiency and profit efficiency. Profitability efficiency is measured with the ratio which provides data to analyse the income with the weighted-costs and with the efficiency of return. Profit efficiency is analysing data between total income and total costs.

The profitability efficiency uses items of cost and revenue and price information. This data in banking is not always clearly defined and it makes it difficult to analyse properly.

(Eskelinen, 2014 p. 21-22)

4) Intermediation

Intermediation uses data of liquidity and belongings of bank. Intermediation proved usually data which is considered to be estimations and the data is not analysed to significantly manage the operations due to the fact that it is difficult to analyse it accurately with the daily business activities. (Eskelinen, 2014 p. 20)

3.3. Efficiency of Finnish banks

The following chart uses an efficiency measurement C/I, which is a figure that analyses efficiency.

The C/I – figure is measurement of relation of costs and income. The lower the figure is, the more efficient the bank generally is because it means that the bank has been able to maintain the balance between handling the costs and keeping the income growing. (Wood, 2007 p. 29)

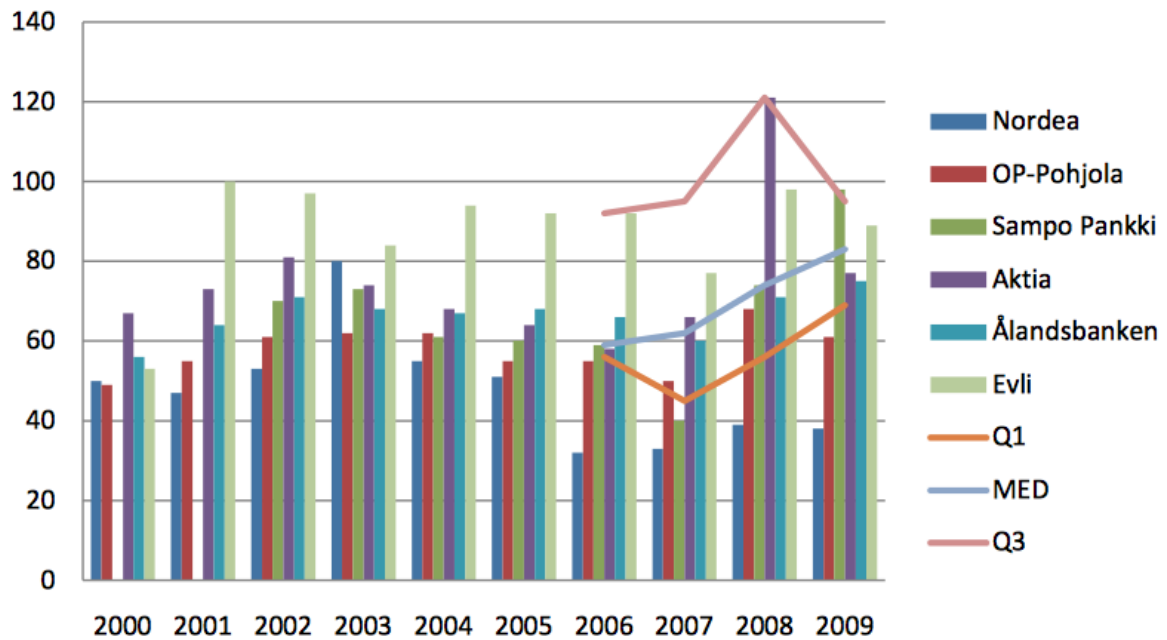


Figure 9: C/I – figure of Finnish banks

Source: (finanssivalvonta.fi – pankkien vuosikertomukset)

The chart is an efficiency development of Finnish retail banks in the years 2000-2009. The C/I figure shows clearly how the bigger financial institutions Nordea and OP have higher volume. The figure shows also the fact how the banks survived the financial crisis. For example, Aktia is clearly showing huge growth with their C/I, which means that they have not been able to maintain their costs and income in balance.

3.4. Efficiency of Osuuspankki

The banks have traditionally been forerunners in adopting new approaches to improve operating efficiency. However, no standard system exists to benchmark the bank branches. The performance of the branch sales activities of for example Helsinki OP Bank, part of the OP-Pohjola Group which is a leading financial service group in Finland. The monitoring of branches of Helsinki OP Bank has so far been done on relatively short-term basis (Eskelinen, 2014. p. 654)

OP Financial Group consists of 173 independent member cooperative banks as of 31 December 2016 and the central cooperative they own, OP Cooperative, with its subsidiaries and affiliates. The Group's operations are based on the cooperative principle – cooperation and sharing the fruits of success with everyone. Based on its mission, OP Financial Group creates sustainable prosperity, security and wellbeing for its owner-customers and in its operating region by means of its strong capital base and efficiency. (OP, 2016)

The Group has increased its capital adequacy and profitability targets (CET1, target 22% and economic capital return target of 22%) and it seeks to achieve a new level in business efficiency by, for example digitalising and automating processes (expenses in 2019 lower than 2015). The development investments required by upgrading and streamlining business will add to the Group's expenses and weaken Group profitability before the benefits from such investment are realised in terms of better financial indicators. (OP, 2016)

As OP's values are "OP is the largest Finnish financial group, which main objectives are to maintain strong financial stability and efficiency to maintain financial success, wellness and safety to its owner-customers and environment. (OP, 2016)

3.5. Conclusion

Efficiency in banking is collective result of much broader aspect in the operations of bank. Efficiency has tools to measure it for example, C/I – model which indicates how the costs are in relation with income.

Overall, efficiency has lots of ways to calculate but the accurate and specific information is hard to provide.

The ‘‘superficial’’ results such as C/I – rate is easy to provide but the use of it is too universal

OP is leading bank in Finland for efficiency and they have always been the first ones’ to find new solution to find efficiency, although it is difficult to achieve.

CONCLUSIONS

The theory started what the banking is Finland practically is. Banking in Finland is a small market but it operates efficiently in Finland as most of the banks operating in Finland are either Finnish or subsidiaries of Nordic banks.

The theory also showed what kind of aspects a modern bank has nowadays and the example for it was OP, which also works as an example for the whole Thesis. The aspects are constantly growing as the banks are modernizing to new fields.

The theory then continued with the aspects of competitiveness and environment in the Finnish banking sector.

The banks compete in many different levels as the first part of the theory showed, that the banks are now operating in many fields. Some banks are focused on different things but mainly all the banks operate more or less with the same aspects.

The regulations and the overall environment of the banks has changed, especially after financial crisis and the operations and competitiveness of the banks has changed.

The last part of the theory handled narrowly about the efficiency of the banks. Efficiency is the main part of the banks' operation but it is narrowly hard to define. There are tools to analyse it further but it takes comprehensive analysis to make exact and fine results. C/I – model is one option but it is too simple to make clear definitions about efficiency.

The most vital conclusion throughout the whole thesis is technology. Technology is the one most important aspect in modern banking and banking competition. The whole industry is in a change which all concludes in to technology.

The whole theory suspects that banking in Finland is healthy and competition in a small market is fierce. The larger banks with large resources have a competitive advantage in comparison to smaller banks. Larger banks such as OP have resources to be more competitive and efficient and can handle better with environmental changes.

The whole banking sector is facing a huge change and the banking sector in the future will not be as traditional as it used to be. The banks are not anymore making the traditional banking operations like they used to and also they operate in completely new fields.

OP itself as an organization has realised the changes in the trends in banking. The group has made huge changes regarding to be competitive in the markets by adding new layers in their business activities such as hospitals, electronic cars and other innovations that make their business more complete and customer-friendly than the other ones. The most important aspect for OP's business is to be technologically advanced and to be able to offer the consumers the most easy but still safe and in a way traditional services that is possible.

Overall, the banking is one of the most important institutions for people all over the world and they will continue to be as banks also develop along side the other world. For the future, it can be expected that banks will be part of much more in people's everyday life as the whole industry is growing.

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APPENDICES

APPENDIX 1. INTERVIEW

The aim of the research is to get practical aspect on the basis of the theory and to analyse the theory from the practical point of view. To achieve this, I plan to conduct an interview in order is to collect information about brand identity from an experienced banking professionals. The questions asked are related to the theory of this research paper and this interview aims to give more pragmatic view on how brand identity is handled in the business world.

The interviewees are experts in their field and have a lot of pragmatic knowledge about the certain field.

Expert interview as a qualitative research is the suitable technique to analyse the theory. Expert interview gives technical, process and explanatory knowledge that is not otherwise accessible. The questions for the expert interview are open-ended and mostly based on the motives, routines and beliefs of the interviewee.

The expert interview gives detailed explication normative stance and pragmatic view of the regular working environment.

The questions were originally represented in Finnish and afterwards translated into English.

The interviewee is service manager of OP, Turku and the interview took place in the facilities of Turku OP and it took approximately 1 hour.

1ST – PART

1. In which segments does the operations of OP consist of?

The mayor parts of the operations of OP are banking, insurance and asset and financial management. Also nowadays the new operational part is the matrixes; digital operations which are constantly under development.

1.1. Is OP Lab one of the mayor innovative operational aspect of OP?

OP Lab itself is not an operational aspect but the development that are done in OP Lab are part of the new digital operation. For example, new innovations that are being under development all over the world; even in Silicon Valley in the United States of America where OP has its' own operational business, which are focused on new innovations.

OP has been investing in new innovation really heavily; approximately with 2 billions euros. The new already existing innovations has been transporting innovation, for example car business which is done in co-operation with Fortum. They are planning to build many new recharge stations in Finland and be part of the development of electric cars and their functions. The electric cars, for example are being rented to customers for short periods of time.

OP has also been very active with hospital business and OP already has hospitals in the cities of Helsinki, Oulu and Tampere, all in Finland and in Turku there are development process for the hospital going on. The hospital business for bank and especially OP is perfect as OP has insurance operations which can be directly connected with OP hospitals. The focus of the hospitals is to be able to offer quick health services, for example for workers. The hospitals of OP are now focused on long-term illnesses and really hard medical operations but rather quick services for ‘smaller’ injuries. Also the hospital are built to be efficient with their services and quality.

OP is also developing innovation in transportation, electrical payment, payment security; banking in general and not only withdrawal and deposit – actions, asset and

financial management, electrical payment and not only the actual payment but the services with it, logistics in the internet services.

2. *What kind of future expectations does OP have in terms of their own operation?*

The major part of the future of OP is to be original and not follow any norms or what the competitors are doing. The operation is based on the demand of customers and what they want to have and what is their vision. The bigger aim for OP for the future is to be able to be more quick in developing services that the rest of the world. Original bank is not anymore nowadays competitive.

3. *What kind of different working environment changes has OP done in the period of quick changes in the field?*

The actual changes in the business models, renovation of office network. The mayor part also of the office network is that OP is trying to slow down the reduction of separate bank offices. One reason for that is that certain type of consumers want it and also the business type of OP (co-operative) requires it in some sense.

3.1. *What matters does OP does, so that the quick changes are more efficient to make?*

Investing in services and digitalization. Like said, OP has invested billions in them and already has a huge amount of potential projects. Some of them will turn out to be really beneficial and of course some of them will fail. In that why; trying the new innovation such as Pivo and mobile services are being developed.

3.2. *OP has recently launched a payment application which has been out in the markets by Danske Bank. Tell me a bit; why are you now bringing it as they already had it?*

Well Danske Bank was really the first one to make such application but the risk what always all innovations have is that you make them too early. In this case it happened as they made their own application independently are we made our application with other banks in Finland and now we have joint application which works better for larger group of consumers.

Sometimes it is risky to be too quick.

4. *How important role does your company form (cooperative) has and how does it show in your operation?*

Well, the cooperative company form has recently being perceived as old-fashioned and country-style form of company. However, nowadays it is really trendy way to run business and many young entrepreneurs in Finland do it such way.

The way for example, how Nordea does it gives them more advantage in the international markets, which they are succeeding really well with their subsidiaries around the world. OP operated differently and they are satisfied with the way their working model is functioning. They are also able to have business co-operatives in different countries but in different way than ‘traditional’ company forms have.

5. *How the term banking as a separate industry is changing?*

Like I have told before; we have been developing many new innovations to be more competitive. It is impossible to be competitive without new operational aspects of banking. Also companies are required to make profit no matter what, what is the reason why banks and OP has to develop constantly.

6. *What are the trends in financial sector that OP is trying to raise in their operation?*

For example, mobile services; all the financial services are nowadays functioning with mobile phones. Of course also the electrical services, web-negotiations and other

channels of communication. All except the traditional face-to-face communications are growing. OP in fact is the only bank in Finland which is still really focusing on traditional face-to-face communication form. OP's web communication is actually just about 3% of all communication, when Nordea has 15% and Danske Bank has even 40%

2nd - PART

7. How does the OP's operations differs from the other large banks operating in Finland?

OP is expanding their businesses more aggressively than other banks in Finland. OP has lot of more new things and the traditional parts of the banking are the same with other banks; of course the qualities of that are different. OP has more separate offices; which makes them in that aspect more controlled and customer-based. Other banks are more radical.

Also, the form of company of OP is different, of course. OP has also taken the lead role in developing joint-good for the community in Finland.

8. What kind of opportunities has digitalization brought in operation in banking?

The digitalization bring constantly new things to the banking sector.

9. What kind of threats has digitalization brought in operation in banking?

It brings of course new competitors to the markets; competition opens. New directives are brought up to maintain digitalization. Digitalization also bring threats to criminal actions and other safety issues.

For example, Danske Bank suffered really critically when their digitalised services failed and did not function for a few days, even weeks. The reason was when they changes from Sampo Pankki to become Danske Bank. Customers remember accidents like that and do not like it.

9.1. What kind of other threats does banking have other than in digitalization?

Of course, financial crisis's, regulations and directives, interest rates can be a huge problem in the future. For example, OP is trying to make financial tools to protect people from the interest raises. If for example, someone is earning 2500€ a month and have loan of 200,000 and the interest rate is 1%; the shock starts when the interest rates start to raise and the payments are raising.

10. How has the operation of OP developed in the period of digitalization?

I think we have already discussed the most of them but the mayor parts are of course the mobile and the other digital services.

3rd - PART

11. What kind of main aspects has the financial crisis changed in the operation of OP?

Overall carefulness, the slowing business, the whole world reacts to the crisis and that makes the banking to maintain important role, the EU-directives, to government and EU makes new regulations to follow which can be really expensive for example in loaning methods. For example; the most of the loan banks can give is 90% and the percentage is really strict and has to be followed really carefully. Overall, many things have changes in the financial crisis and many things will change if they happen in the future.

THE CONCLUSION OF INTERVIEW

The interview was a fascinating way to get empirical knowledge for the thesis. The answers were good and came from real professional of the banking field. The knowledge I got to the paper was really straight-forward and practical and there was many new things I got to my paper for example, about the new innovations of OP.

Author is really content with the results and I think that this form of empirical study suited perfectly for this thesis-paper. The content of the theory was formal and contained large amount of number, figures and charts and this interview gave a lot more practical way.

Also before the actual interview I got really many tips on how to find right type of information for this project from the interviewee. These tips really helped me throughout my process.