Chapter 73
Innovation in Business Models of Banks in Europe: Towards a Methodological Approach

Konstantinos Liakeas
University of the Aegean, Greece

Anastasia Constantelou
University of the Aegean, Greece

ABSTRACT
Since the end of the 1990s, the introduction of Internet technology to the mainstream technologies used in businesses led to the expectation of pure Internet enterprises that might eliminate physical presence to one or more points in the value chain. A sequence of failures managed to resize those expectations and led most firms to just expose routine back end systems transactions through the Internet without a clear focus on relationship building or an integrated cross-channel sales approach. Despite the structural changes to the business level strategy that the Internet may have brought to firms in many industries, business practices in banking have not really evolved. This is because banks perceived Internet-based innovation as an investment opportunity that could raise spatial and temporal constraints much like ATMs had done in the past, without actually changing the value proposition of the business model or the strategic options of financial institutions. This chapter argues that the degree to which financial institutions have actually infused innovation into their traditional business model has been negligible and aims to set out a scene for the study of the evolution of strategy and business models of banks in the Internet era.

INTRODUCTION
The introduction of internet technology to the mainstream technologies used in businesses, led to the expectation of pure internet enterprises that might eliminate physical presence to one or more points in the value chain. Especially in the cases of non-tangible goods or in cases where parts of the value chain could become dematerialized - like money transactions, telecommunications spectrum, software or music - expectations were really high and in some cases business plans were justified based on these expectations in order to support such e-businesses (for example, pure e-
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bank entities like Egg). A sequence of failures managed to resize those expectations and led most firms to just expose routine back end systems transactions through the internet without a clear focus on relationship building or an integrated cross-channel sales approach. This resizing of expectations led in certain cases to a mismatch between the initial decision for an additional revenue stream that would result from shifting business online, and the actual multi-channel approach that was finally adopted. In the banking sector, in particular, this was especially obvious in cases where e-business was implemented through an additional channel and not as a pure e-bank entity.

Although in certain industries (ICT, retail commerce etc.) internet technology has led to a differentiation in the business level strategy and business models, in the bulk of the traditional banking sector business practices have not really evolved. Despite the structural changes (to business level strategy or business model) that internet may have caused to firms in most industries, the banking sector seems the least affected. Most banking institutions perceived Internet-based innovation as an investment opportunity and funded businesses that based their business models on these technologies. However, as this chapter argues, the degree to which these institutions have actually infused innovation into their business models has been so far negligible. This initial perception has been our primary stimulus for an in-depth investigation into the ways in which the strategy and the business models of banking institutions appear to have evolved in the Internet era.

Our starting hypothesis in this chapter is that, in this changing environment, incumbent banks opted to push their existing business models to the extreme - underestimating in many cases lending risk (Nellis, McCaffery, & Hutchinson, 2000) – than to investigate the opportunities offered in the provision of higher value products and services. The latter stem out of the observable deconstruction of banks’ traditional value-chain activities and the revision of their current approach in conducting business. This chapter aims to function as a provocative first attempt to explore the validity of the aforementioned hypothesis. To do so, it develops an analytical framework that allows for an in-depth investigation into the evolution of business models surrounding the operation of commercial banks in Europe over the last decade.

The chapter does not aspire to unfold a fully-fleshed theoretical framework regarding the complexity of the dynamics shaping the banking industry in the Internet era. Rather, drawing upon observed industry trends, it uses a methodological approach that allows for the measurement of the “behavior” of an organization, that is the initiatives stemming from its business plan, the processes, and the performance metrics used to plan and realize its business model. To this end, the aim here is to go one step further and develop an operational tool that can guide future work in the identification of innovation in the business models and business level strategy of commercial banks during the first years of the Internet era.

The structure of the chapter is as follows: the following Section Two summarizes briefly the main arguments found in the literature regarding the impact of Information Technology (IT), and of the Internet in particular, on the banking industry and the subsequent emergence of new business models in the banking sector. Section Three presents the theoretical elements upon which a conceptual framework is built for the study of the behavior of incumbent banks in the networked era. This conceptual framework guides the empirical investigation in the subsequent Section Four of the main hypothesis stated at the beginning of the chapter. The Concluding Section summarizes the main arguments posed and proposes directions for further research.