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A Matter of Balance: On Corporate Governance and Strategy of the Rabobank

1. INTRODUCTION

The environment in which we work is changing at a rapid rate. Clients and their preferences are changing, the institutional environment is changing and (other) suppliers are adjusting. None of these changes are happening independently, they enforce each other. Can a cooperative organisation deal with these changes? Only if it knows how to adapt.

To give you a feeling for this it helps to look at what goes on from a different perspective than the one common in nowadays business practice. I will start with an analysis by Collins and Porras, named 'Build to last'. They are not 'under suspicion' as they have no special relations to the cooperative inheritance. They state that companies that are successful over a longer period of time have two things in common. First, they stick to their core, being a bit more than just short-term money making. Second, they have an urge to change; and they manage to find the right balance between these two. For a cooperative organisation this can be translated in: choose the manner in which you want to take your place in the world, know your strength (and limitations) as well as adapt to changes in the environment, develop a sensitivity to market dynamics and act accordingly.

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History

- 1896 First local cooperative bank in the Netherlands
- 1898 Establishment of central banks (2)
- 1972 Merger of the central banks
- 1980 Start international activities
- 1990 Interpolis (insurance)
- 1991 Robeco (asset management)
- 1996 Reconfirmation of cooperative nature
- 1998 Centenary Rabobank Group

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Using this model one can see a similar development in many cooperative firms. For decades many cooperative firms managed to stick to their core. There was no reason not to do so as the environment changed only little by little. As the speed of change increased beginning in the seventies and still increasing nowadays, the dynamics entered into the cooperative firm. Quite a few firms decided to abandon their cooperative structure, as this was felt to slow down the necessary changes. The Rabobank is showing a similar development, though we did not abandon our cooperative structure, something quite uncommon nowadays in the financial services sector. On the contrary: we re-enforced the Rabobank having been a cooperative only a few years ago.

Please allow me to introduce the Rabobank to you and moreover the way we stick to our core and adapt to market dynamics. I will do so by taking you along the profile, corporate governance and strategy to deal with all these at the Rabobank.

2. PROFILE OF THE RABOBANK

The Rabobank is a two layered cooperative. The organisation comprises local cooperative banks in the Netherlands, a central organisation including Rabobank International and subsidiaries

Domestic market shares

- Corporate customers
 - Agricultural sector 85 %
 - Small and medium-sized companies 38 %
 - Large enterprises 12 %
- Private clients
 - Residential mortgage 25 %
 - Private savings 40 %
 - Investment funds 35 %
 - Insurance 10 %
 - Payment services 35 %

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Key Figures

- Top 40 of largest banks in world
 - Balance sheet: Dfl. 550 bln.
 - 47,000 Employees
 - 2,464 Branches
 - 144 Foreign offices
- Triple A credit rating
 - Net result: Dfl 2.1 bln.
 - BIS-ratio: 11 %
 - Cost/income ratio: 1.42

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for specialised financial services, both national and international. The business we are in is financial services. One hundred and one years ago we started as a local credit union; from this we developed to a universal bank and later on to an all finance services provider. Today we are a broad financial service provider in the Netherlands and a specialised provider of financial services for food & agriculture, healthcare and financial institutions on a global scale. Our mission is stated as providing customer value. I will come to what we think this is in a moment. For now I will show you some figures for our organisation to give you a first impression. Worth noting is that today only a small part of our clients are members. These members have voting rights at their local bank. The local banks own the central organisation and through this the subsidiaries.

3. CHOICES RABOBANK MAKES

Our ambition statement claims that the core objective of our organisation is the realisation of customer value through being a broad cooperative financial provider with a distinctive orientation towards our customers. For us customer value is: the provision of products and services in such a way and of such quality that the customer experiences a sense our point of departure is his own interests. This is not the same for every client; it is the client that decides on this.



Choices Rabobank makes

- Reconfirmation of cooperative nature
 - distinctive mission: customer value
 - broad all finance services supplier
 - open for all our customers
 - strengthen our membership base (feed-back loop)
- And ...
 - focus on long-term relations with customers
 - strong relation to local society
 - socially responsible entrepreneurship
 - sustainability

Until a few years ago clients who applied for a loan for business reasons had to become a member of the bank. These members were liable for the bank (decades ago they were fully liable; later on this changed to a limited liability). Nowadays our organisation is open to all our customers; they all can become members if they wish to do so. Members are not liable anymore. We welcome new members as they can be seen as one of the most effective feed-back loops one can image. They are willing to make the effort to get the organisation in the right direction. This can be products and services developed especially for clients in a specific local context or for specific market imperfections.

We aim at long-term relations with customers. So, the continuity of our organisation is a key issue. That is the only reason for us making profits: to earn money to be able to do (banking) business in the years to come (as we take no external capital for our core business). A special item – at least in banking – is the strong relation to the local society and people. As we have our roots in the agricultural society our interpretation of 'socially responsible entrepreneurship' comes with an accent on sustainability.

4. CORPORATE GOVERNANCE

A special item in cooperative enterprises is always corporate governance, often referred to as one of the major weaknesses in respect to the capability of adapting to changes one should really adapt to. I will enlighten this subject on two levels, the organisation as a whole and the individual local bank, as well as the interaction between these two. Let's start with Rabobank Nederland, the top level cooperative. The board of this organisation consists of two bodies, the Board of Directors (chosen by representatives of the local banks) and the Executive Board (professionals), which have a shared responsibility for steering the organisation. Business development is managed by the Executive Board, cooperative items are the main responsibility of the Board of Directors; but one can easily see there is no sharp distinction between the two. Besides this there is a Supervisory Board, also elected by representatives of local banks.

The situation in corporate governance within our local banks kind of looks like the situation in Rabobank Nederland. There is also a Board of Directors and a Supervisory Board elected by the members. The management, sometimes one person, but moreover a team, are professionals. There is no shared responsibility: in the end the Board of Directors is responsible, although the position of the managing director will be at stake if things are not working out the way they should. To tackle the problem of lacking banking expertise in the Board of Directors, the managing director of the local bank is part of the Board of Directors, having voting rights as well.

Quite important within our organisation is the feed-back loop from the local banks to the board of Rabobank Nederland. There is a system in place where local banks participate in

regional meetings and these send representatives to a national meeting, which gathers four times a year. In this meeting of the local banks the main topics concerning business development (and a lot of other items) are being discussed. Officially this national meeting of local banks can only advise the General Assembly, but in fact no board dares to do something that is not in line with the opinions in this national meeting. In fact this is where decisions are made. To illustrate this: I cannot remember one item on which we had a major discussion in the General Assembly and the voting was not unanimous. This is not the case in the national meeting of the local banks, where fierce discussions take place, although there is no actual voting in this meeting.

Besides this system of meetings of (all) local banks there is a system of consultations of representatives from some local banks on specific issues, like market segments, management development, ICT-systems, communication, etc. And there is always the possibility to discuss a real major topic with all the local banks in a special way. We did this a few years ago when we raised the question whether the organisation should still be a cooperative and if yes, what this cooperative should look like. And of course the 'usual' standard top-down communication. Within our organisation this is not as usual as one might expect, because there are a lot of items the local banks can decide on by themselves, for instance pricing policy.

5. MARKET DYNAMICS

Financial services can be characterised as a market with fierce competition and a tremendous speed of change. I dare make the statement that looking at a cooperative working in a market like this from a static point of view is missing the point. Let me highlight to you just the major changes in the world we are working in to emphasize this.

6. CHANGING CONSUMER BEHAVIOR

A portion of our client base is becoming less dependent. Clients and their needs are central. It is up to financial service providers to find a solution that suits customers. This can be done by a service or combination of services specific to a client (individual or business) or a group of clients. This is often possible with products designed beforehand, but not always: a solution may only exist by means of interaction between the client and the financial service provider.

We see that consumers themselves choose which services they value and how to get them. Depending on his need and to what extent he would like to participate in the search the consumer chooses a provider. The provider chosen can vary per need or even per transaction. Many clients still choose based on the confidence they have in a provider. Consumers also

Market dynamics (1)

- Consumer behaviour
 - solution driven
 - choices will vary at different times and in different situations
 - securitisation
 - cross-border activities and mindset
- Perception of financial services
 - retailisation; some financial services becoming infrastructure
 - innovation; integration; growing complexity, innovation
 - predefined products plus ‘interaction based’ services

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choose the means of interaction for themselves. The choice will vary at different times and in different situations. It is to be expected that just about every consumer will opt for a combination of distribution channels, depending on their requirements and mood at the time.

The consumer’s perception of risk and willingness to take risk is changing. A number of clients are now accepting solutions with higher risks. There is a huge upswing for tradable assets (for example securities). Business people have new opportunities to attract funds to conduct their businesses other than through traditional banking channels. The position of a bank with this non-interest-based business is completely different from the one in interest-based business.

Changes in Europe are effecting our clients, individuals and particularly businesses. Cross-border activities are increasing and the range of clients is getting a more European character. Customers are becoming less tolerant of discontinuities at the national borders (in price and content) in the services and infrastructure they consider standard.

7. PERCEPTION OF FINANCIAL SERVICES

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A number of services that were only available for the top of the market are now also available for large groups of customers in the retail business. Basic products in the package of services

such as payments will be standardized to such an extent that they are becoming 'infrastructure'. Customers of these products can hardly distinguish the various service providers anymore. An organisation can only attract attention in a negative sense. Solutions for customers no longer originate from either banking, insurance, or asset management on their own, but will often be a combination of them. Financial services are being developed, involving a number of financial disciplines. These are being realised by combing the various competencies of financial service providers in a sensible way for customers.

At the 'top' of financial service providing changes are constantly happening. Combinations are made that were hardly useful before, or even unthinkable before. The complexity of financial service provision is increasing enormously, to such an extent that many have lost their way. Many products and services are designed beforehand, but the question remains to what extent they solve the individual customer's problem.

8. ELECTRONIC INTERACTION

Internet technology is becoming available to large sections of the population. Already, a large number of the transactions in financial services are being carried out electronically and the first forms of electronic distribution are becoming available. This technology is allowing customers to make their own choices in the pool of suppliers. One can see customer-driven systems replacing product-driven systems bringing with it a restructuring of the distribution processes.

The rise of the Internet is making it possible for creative and enterprising individuals to reach large groups of people at low costs. This will weaken the market position of existing parties as it implies a fundamental change in the cost base to provide financial services as well as it limits access barriers to enter the market. A large impact is expected of suppliers offering their services over the Internet. Suppliers such as Microsoft are setting up transactions systems and if – as expected – the transition from closed to open infrastructure becomes a fact, these new suppliers can encroach on the areas traditionally reserved for the banks.

Electronic interaction will saturate financial service provisioning: transactions will be made almost completely electronically; standard products can be purchased electronically; calculation models and advice systems by which customers can make their own choices will become available; personal advisors will be available by means of a visual link. This will change the nature of the interaction between the customer and his financial service providers. Interaction in person will not disappear altogether, but will occur in situations in which the customer deems worthwhile.

Market dynamics (2)

- Electronic interaction
 - allowing customers to make their own choices
 - changes cost base, limits access barriers
 - repositioning of personal interaction
- New competitive platform
 - new entrants; new distribution channels
 - agents
 - upscaling and/or specialisation with existing players
 - fierce competition: squeezing margins

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9. NEW COMPETITIVE PLATFORM

New entrants are doing a lot of experimenting with new forms of distribution. We expect that supermarkets and petrol stations in particular will be the first to develop activities in the domain of financial services. At the same time privatised organisations in the area of social security will expand their package of services with all kinds of financial services.

All around us we see the number of agents helping customers to find their way and make choices in the growing complexity of financial services. People are establishing themselves as independent advisors, specialised in customer specific service provisioning, and are a good alternative for non-business customers to large service providers. The number of business advisors who are not or only to a limited degree associated with large organisations are playing a more significant role as independent advisors of SME's. Being independent they can deliver the same quality without the burden of a large organisation.

We see that many parties, driven by shareholder value need autonomous growth. This cannot always be realised by means of existing products on existing markets. We see growth happening in the financial world by means of increases in scale. After the first domestic mergers and steps towards all finance, large cross-border mergers are now occurring. In this way

organisations many times larger than the ones we are dealing with now are being created. Only a few will succeed in continuing to play a role independently in all areas of Europe or even world-wide. We think that only about ten players will cover a large part of Europe with an extensive supply. Next to them, a large number of 'regional' parties in several countries of the European Union will continue to offer packages of financial services.

An environment with a large number of new participants has come about, via Internet or personal interaction, on a small scale or large scale, agents and niche players, who are determining the playing field for financial services.

10. VISION ON DEVELOPMENTS

Dynamics and limits to what can be shaped

The dynamics of our environment have increased substantially. It is impossible to know everything beforehand in this kind of a world: innovations in financial services are sometimes intended, but sometimes they just happen. This will put the continuing powers of perception to the test and demands recognition and sensitivity to what is happening to customers. People working at the grass-root level of organisation, communicating daily with customers play a key role here. Also members providing feed-back are of invaluable importance.

Dynamics also imply that one cannot create everything. This is evident for customer value. Product suppliers add customer value by means of their expertise: they think by means of their expertise on content and try to be of service to customers in this way. Technology and systems are the key factors in this. An entirely different competence – from the customer's perspective – is the ability to search for a solution to his demands and desires by translating them into a potential offer of services and products. We take the customer in his specific context as the point of departure and we assume that customers are different: each customer has a different way of interpreting what customer value is. Based on their expertise, employees try to find solutions the customer feels are appropriate. This has been the strength of our organisation for 100 years.

Competencies and scale

For various financial competencies diverse considerations need to be made in terms of scale. Only those products that can be used everywhere and are relatively impervious to market variations require an international scale. Technology and systems play a key role here; scale can generate cost reductions. Products and services that are customer specific demand personal service, and employees play a key role in this. Size and combined strength are less vital for this competence; it's all about making connections here. We have both characteristics in our

Implications

- Limits to anticipating and shaping
 - accelerating dynamics: unable to anticipate everything
 - environment dominates: unable to shape (customer value)
- Core capabilities
 - entrepreneurship and innovativeness
 - employees and sensibility
 - products and systems
- Considerations on scale
 - large when no differentiation necessary
 - limited size when differences do matter

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business, and this demands our being able to use both forms next to and supplementing each other. This demands a great deal from both the board and management.

Raising the tempo

The dynamics in our environment results in three statements which are fundamental to the development of an organisation like Rabobank: Market dynamics are so strong that we are unable to anticipate everything; the market will always be ahead of us. Internet and open markets have caused a much greater competitive platform and we are confronted by creativity on a global scale. We have to be innovative and entrepreneurial in order to be part of the dynamics and creativity of our environment.

We will only be able to play a role in the dynamic world as described above if we succeed in seeing where we can do things and where we cannot guide and plan; if we are aware that we do not always and necessarily have to respond at board level to individual developments; if we, therefore, also have the courage to trust in the strengths and potential that lie at the basis of our organisation. In addition to powers of perception, this is all about the manner in which we want to take our place in the world.

11. CORE OBJECTIVE AND POSITIONING

Customer value as central objective

The Rabobank organisation comprises a diversity of expertise that together facilitate our being a broad financial services provider. Customer value is created by: employees who form a bond with customers and assist them with financial products and services (these employees can be supported by systems); making products available that are system-driven (these may be a feature of the relationship that a customer has with us).

In order to provide customer value, it is crucial to select employees appropriate for the customers they are serving. These employees need scope to do what they, together with their customers, consider necessary and appropriate. This puts HRM at the heart of our organisation. The capacity to provide customer-value products that are competitive in the market and easily accessible is also a prerequisite. This is facilitated by the use of modern ICT that enables customers to have direct contact with the bank's systems for transactions and simple products. The employee serving the customer must have access to a wide range of financial competencies and be able to design solutions for his customers.

The Rabobank organisation as network: coherence and differentiation. We regard the Rabobank organisation as a network whose core is formed by the affiliated banks. In addition to the

The way we act

- Customer value
 - employees supported by systems; products and services
 - solutions that are suitable to clients
- Network
 - affiliated banks; units for specific competencies
 - coherence plus differentiation; steering accordingly
- Positioning
 - Rabobank in the Netherlands: personal interaction 'plus'
 - internet based direct channel? multi-domestic in Europe?
 - focussed international business

local banks and RN-AB, the central unit for the local banks, corporate entities offering specific competencies in the fields of banking, insurance and asset management are also part of the network. The corporate entities share the same objective, which is to realise customer value.

The differentiation between corporate entities is expressed not only in the manner in which they provide customer value but also in terms of the ratios employed, employment conditions and cultural aspects. Each corporate entity will choose a form which is suitable for, and which allows it to be at least in line with the market and the state of the art in terms of technology and marketing.

Positioning of the Rabobank in the Netherlands

The affiliated banking business operates under the brand name Rabobank in the Netherlands as a broad cooperative financial services provider with strong local roots. The members of the local bank form a key group in helping their bank determine its direction and choices. The cooperative orientation is expressed in the manner in which local banks relate to their customers and in the type of activities they develop. Both locally and centrally we can contribute to the continual alertness to developments and market imperfections that exist.

Personal service is a key element; local bank employees know their customers and their contexts, and this enables them to add value by providing financial services. Technology, Internet and systems that enable the customer to carry out transactions direct will often be part of the bank's relationship with the customer. But whenever a customer so wishes, he is able to fall back on the local bank which is able to guide him through the choices or act as advisor.

Positioning of other brands

With Internet technology assuming an even greater role in financial services in the coming years, research will be carried out shortly into the feasibility and added value of an additional distribution channel. This would then be a direct channel based on Internet technology. With this we would opt for a second value proposition in the Dutch market, one which is distinct from that in the affiliated banking business.

Positioning in Europe

What we are discussing now within our organisation is a concept not just in the Netherlands but also – in a limited way – in Europe and the rest of the world. To this end we want to form a multi-domestic business with European partners. The basis of this is contained within each of the partner's domestic business. In addition, a number of financial competencies can be brought together in shared, specialist competence centres which have a European dimension and we would be able to call on our European partners to serve our Dutch customers abroad (and vica

versa). This concept to persevere with the essentials of our organisation in the affiliated banking activities and ensure that each of the corporate entities is able to measure up to the European market.

International positioning

We have opted for a 'global niche player' position in the international arena, where there is a focus on food & agribusiness customers. We prefer to continue to champion a focus strategy and seek our added value and profile through distinct knowledge and expertise in a selective number of fields. However, this focus can be expanded if we team up with European partners.

Epilogue

With this I tried to give you some insight into what we think is and will be happening in our environment and the way we are thinking on how we can deal with this. We tend to focus, but there still are a lot of challenges to us. With this we don't think we can shape the world; but we can try to be prepared for it. It is up to our customers to decide whether or not we will do so. ■