

“Evaluation of the impact of the emergence of the Internet on the business strategies of the Banking Sector in the United Kingdom specifically the 10 independent banks in the United Kingdom.”

ACKNOWLEDGEMENT

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ABSTRACT

An abstract of what is in the report follows the contents page(s). It should be no longer than 500 words and preferably fit on one double-spaced A4 page. Its purpose is to inform the non-expert reader of the basic nature of what is discussed and of any conclusions, enabling them to decide whether to read the report. It should be typed on a separate page.

CHAPTER 1 INTRODUCTION

1.1 Background

We see the impact of information system/information technology or IS/IT and the Internet on the way we live, and we see this everyday. Everything around us is changing. The way we work had changed: we now have telecommuting and now can work at home. The way we study had changed: we now can get a degree from a European school without ever leaving our home country: in the United States alone, there were 3.2 million students taking at least one online course in 2005¹. The way we bank had changed: we now have virtual banks which don't have physical branches. Everything around us is changing. And almost everything we do involves money, and when money is involved a bank somewhere, sometime also is. As such in this research paper, I tried to explore how the Internet had changed the banking industry in the United Kingdom.

In doing the research, I explored the topic "Evaluation of the impact of the emergence of the Internet on the business strategies of the Banking Sector in the United Kingdom specifically the 10 independent banks in the United Kingdom" by keeping several objectives in mind. First, determine the magnitude of the impact of the Internet in the banking sector in the country. Second, determine how the Internet and Related technologies affected the way the banking sector does business. Lastly, determine if the observed changes brought about by the Internet on how banks do business have drastically changed the United Kingdom's banking practices. These

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Source: Allen, I. and Seaman, J. 5.

objectives will, in part be addressed, by the classification of the actions banks have adapted in response to the Internet and Related technologies.

The finance sector in general and the banking industry in particular have gotten so complex during the past decade. This complexity was exacerbated by the proliferation of the Internet. A decade ago, no one had dreamed of cashless business transactions such as shopping. This reality, although still in infancy, will become more and more pervasive as society get used to the convenience of having their banks handle their daily financial transactions such as the example, paying for groceries, and automatic payment of utility bills among others. All these show that society and the banking sector exist co-dependently. Society relies on banks to facilitate cumbersome transactions and have more time on important things, and banks rely on society for fees in exchange of the convenience of their service. Today, as the Internet becomes more pervasive in people's daily lives, so does banking. Personal banking is now mobile thanks to wireless technology and cellular phones. An individual can now access his or her bank accounts anytime and anywhere. Investors can now buy and sell stocks and other securities through their mobile phones and personal computers without even facing their banker or broker. The ways banks do their business have changed how people managed their finances and lives.

1.2 Stages of Transition to e-Business

With the emergence of the Internet and related technologies, a new way of doing business emerged: e-Business. It is the execution of transactions electronically. The transition of a so-called brick and mortar business into e-Business occurs in four distinct stages.

The first stage occurs when the firm sets up a Web site to exploit electronic commerce. Many firms are in this stage. However, business managers must realize that web site development and implementation must not be fully delegated to their technical and web developers. Management needs to be involved in defining the objectives of and designing the web site to ensure the success of the firm's transition to e-business.

Stage two involves linking key suppliers electronically to the company's production or service delivery processes. Extending the capabilities of the web site to the supply chains of the enterprise allows the organization to fully leverage the investments it made during the first stage. Stage two usually involves the use of intranet and extranet setups to accomplish the desired extension of the capabilities of the web site.

Stage three calls for the formation of online alliances whereby partnerships and joint efforts are forged by players in an industry or across industries affected by, or anticipating widespread adoption of, electronic commerce. At this stage, manufacturers, service providers, distributors, courier companies, retailers, banks and financial institutions start integrating and coordinating their activities to play their new and enhanced roles in the Information Technology era.

The fourth state, Industrial Convergence, is where there is evident convergence among different sectors to combine their expertise and offer innovative products. At this point, the

resulting business processes may already be very different from the current business processes because of the business and industry transformation expected to take place during its final stage. For example, passengers can do the following anywhere, anyplace, anytime: make airlines reservations using web-enabled booking engines; pay online with their bank credit or smart cards; receive and print electronic tickets or e-vouchers; and monitor their travel requests using the airline's or travel agency's web site. In this example, the industrial transformation will require the expertise or airlines' computerized reservations systems, banks and financial institutions, and even application service providers.

This transformation and four stages are evident on how banks adapted strategies as a response to changes in their operating environments brought about by the Internet and related technologies.

1.3 Research Question

My main research question which guided me throughout this research study is

“How has the Internet impacted the United Kingdom's banking sector specifically the country's top 10 independent banks?”

Additional research questions are:

- In what stages do these banks have integrated the Internet and Related technologies into their operations?

- Who initiated the integration of the Internet and Related technologies into how these banks do? The customers? Or the banks?
- What specific changes have been made in relation to this integration? How significant are these?
- Are the observed changes within the ten banks the same in the entire banking system of the United Kingdom?
- How has these changes impacted the banking industry in terms of cost and revenue efficiencies?

These questions served as my guide in researching for the information I need, and in the writing of this research paper.

1.4 Study Significance and Scope

Through this research study, I aim to understand how the Internet and Related technologies have changed the way banks do business in the United Kingdom. The methods I used, and information I gathered were very specific into addressing this objective. As such, any generalisation I made about the whole banking sector in the country might be incorrect in some situations. However, I still think that in spite of this limitation this research study is nevertheless important. It is important in several aspects:

- It documents the strategies adapted with regard to the Internet and Related technologies by several of the most influential banks in the United Kingdom.
- It contributes to the literature on how the Internet has changed the way banks do business.
- It helps society understand the current banking environment, and hence help the community better manage its finances.
- It helps the government understand the current banking environment, and hence aids in the development of regulatory policies for the banking sector.

In answering my research questions, and in addressing my objectives, I decide to focus on the country's top ten independent banks. The rationale behind this is these banks set the business strategic trends in the banking sector. What these do, other banks usually do. These ten banks are:

1. Barclays Bank
2. HSBC Holdings
3. Royal Bank of Scotland
4. HBOS
5. Lloyds TSB
6. Standard Chartered
7. Alliance and Leicester
8. Northern Rock

9. Co-operative Bank

10. Bradford & Bingley

1.5 Data Sources

The ten banks' strategies with regard the Internet and Related technologies were obtained from these banks' annual reports to stockholders. These annual reports were obtained from the banks' themselves through their Web sites and the London Stock Exchange. Several were also obtained from the British Bankers' Association.

The literatures I reviewed in this study was accessed from ProQuest, an online database of journals.

1.6 Organization

Chapter 1 provides background information germane to the question including stages of transition to e-business, research question, significance and scope of the study, and data sources.

Chapter 2 is an extensive review of literature, surveying the empirical results of previous studies that identify significant strategies adapted by the banking sector as response to the Internet and Related technologies. Topics covered are history of banking, the Internet and e-Commerce, the efficiency motives for and consequences to adapting into environmental changes in the banking industry, virtual banks, and the ten banks used in this study.

Chapter 3 is a description of the research design and methods employed in the study and the myriad details of data collection and methods applied.

Chapter 4 presents an analysis, evaluation and discussion of the research findings.

Chapter 5 summarizes and concludes the research findings, identifies limitations of the research, and makes recommendations for further research.

CHAPTER 2 REVIEW OF THE LITERATURE

Still on-going, not yet finished.

My first plan of action will be to look into current literature on banking and finance, and how has the Internet impacted the way financial institutions do business. I plan to use mainly journals and textbooks for this area of research. I will use key findings I encounter here that relate to the top 10 banks' strategies, goals, and objectives, and draw upon comparisons.

The literature review should provide a critical review of all pertinent material; this gives a clear picture of the current available knowledge and leads to the gap in that knowledge which your report will attempt to fill. The literature review should also include an appraisal of the outcome measures you are considering using. In many cases the literature review will lead to the development of a hypothesis which you plan to test. To ensure that you provide sufficient detail to enable your research to be replicated it is useful to begin by describing the method used to search for relevant literature; for example the databases, key words, and limits such as 'only English language' that you used and whether you found any further studies through cross referencing.

Remember, authors can make mistakes, fail to report the whole truth, be unaware of other work which invalidates their own, or be biased. Papers should be compared, therefore, with each other when they are dealing with similar subjects. Explanations should be sought for any differences in the design and conduct of the study or in the preliminary assumptions.

At the end of this chapter it is useful to show how your conclusions have informed the design of your research.

2.1 Background

2.2 History of Banking

Over the last few decades, the world saw the accumulation of wealth at a rate never before witnessed. This progress was made possible “only through the employment of capital by free and private enterprises” (Bogen 1). The banking industry played a very important role in consolidating this capital from individuals, groups, and firms who have excess capital and making this accumulated capital to individuals, groups, and firms who found themselves in need of extra capital.

During the eighteenth century, “the infrastructure of modern-day finance just did not exist” (Hayes and Hubbard 9). Individual bankers, however, were abounding. These bankers did, to some degree, what financial intermediaries do today – they “worked alone in their efforts to stitch together large financing arrangements” (Hayes and Hubbard 9). These bankers, in time, formed syndicates “to share both the burden of distribution and the accompanying capital exposures” (Hayes and Hubbard 9). How these bankers managed to dispense their lending function was a bit underhanded. At that time, the Catholic Church had, through its dictums, had made usury or the charging of interest rates through lending illegal, thus these bankers lent capital through underground channels. This prohibition according from Hayes and Hubbard “delayed the introduction of debt securities into European commerce and also led to certain

non-catholic groups, notably Jews, and later Protestants, to [specialise] in the money-lending business” (10). The influence of the Catholic Church was this strong because at that time the church and the nations’ governments are almost one and the same. This situation someone progress to the better during the Renaissance when this restriction eased which allowed banks to adopt a more important role in commerce. “by the seventeenth and eighteenth centuries, northern and western European prejudices against lending for profit had diminished” (Hayes and Hubbard 11). With this, banks became more important as the major accumulator of capital in the society by primarily aggregating the savings of individuals.

2.3 The Internet and e-Commerce

2.3.1 The Internet

The Internet is “a worldwide system of computer networks – a network of networks” (Turban, Leidner, McLean & Wetherbe 2006, p. 2006). The Internet has made possible the creation of new business opportunities and industries. The banking sector is perhaps is one of the most affected industries. Another consideration is the growing Internet population in the country. Richard Goosey, international chief of measurement science at Nielsen, said that “Germany, the UK and Italy are now well established as having the largest Internet populations in Europe” (PR Newswire).

2.3.2 e-Commerce

2.4 Efficiency Motives for and Consequences to Adapting into Environmental Changes

Efficiency improvements from adapting business strategies with changes in the firm's operating environment is broadly defined "to include any cost, revenue or risk factors that affect shareholder value other than changes in the exercise of market power in setting prices" (Berger, DeYoung, Geray & Udell 2000, p. 10). This definition is premised upon the presupposition that, in the long run, only business strategies that increase efficiency or do not appreciably reduce efficiency are sustainable. Thus defined, banking institutions continually updating their strategies vis-à-vis their environments may achieve superior cost and revenue scale, scope, and product mix, as well as increase shareholder value (Berger et al., 2000).

Most generally, efficiency gains are thought to flow from the expansion of the bank size and scope, and from the integration of bank processes by the Internet and Related technologies. Of these increased operating cost efficiency is most commonly mentioned. However, cost efficiencies are not likely to be monotonic, i.e., costs in banks which responded to the changes brought about by the Internet can only be lowered, scale, scope or integration are relevant, and if the change is significant. Integration of bank processes by the Internet and Related technologies may help for some specific processes, while it might disadvantage other processes. Moreover, some bank services benefit from the integration of bank processes by the Internet and Related technologies, and making these bank services available outside of the bank's premises.

By integrating of bank processes with the use of the Internet and Related technologies, banks are given the opportunity to expand their product mix. As a result, banks can improve their cost efficiencies in the long run.

Expenses may be lower if bank can offer several products at a lower cost than separate competitors offering a subset of the full product array (Berger, Hunetr & Timme 1993). According to this view, the evolving financial structure may enable banks utilising available technologies to offer more products and services, and the same technologies may allow providers of multiple products and services to produce them at a lower cost than their counterparts who stick to the traditional way of doing business. This will lead the former to garner an increase in market share of targeted customer activity at the expense of the latter (Thakor 1998).

Ferrier, Grosskoft, Hayes and Yaisawarng (1993) used a new measure, economies of diversification, to examine the cost effect of product line expansion in the banking industry. They found diseconomies of diversification and technical and scale efficiencies were more important determinants of bank costs than the failure to operate at optimal scale. The new environment will certainly allow British banks to go into new lines of business.

Revenue efficiency effects may result as financial institutions can now easily expand internationally in order to follow their multinational customers. Banks may not need to establish physical presence in countries to where their clients do business. With the Internet, banks can establish virtual presence that is as effective as a branch in several markets. Revenue scope efficiencies arising from reductions in customer transaction costs may occur as consumers elect

to pay more for the convenience of real-time, anywhere banking. The result will be higher revenue and a better return from any customer segment (Berger, Humphrey & Pulley 1996).

These efficiencies drive banks to search for business strategies synergised with the developments in the Internet and in information technologies.

2.5 Virtual Banks

2.6 Top 10 Independent Banks in the United Kingdom

By a research done by The Banker's Terry Baker-Self, Beata Ghavimi and Giulia Paoli in 2006, the top banks in terms of total assets in the United Kingdom include Barclays Bank, HSBC Holdings, Royal Bank of Scotland, HBOS, Lloyds TSB (The Banker). To complete the ten banks I need in this research study, I added

Standard Chartered

Alliance and Leicester

Northern Rock

Co-operative Bank

Bradford & Bingley

2.7 Summary and Conclusion

CHAPTER 3 RESEARCH METHODOLOGY

3.1 Research Question

This study examines the impact of the Internet on how the banking industry in the United Kingdom does business starting from 2001 which is about the time that the Internet started affecting how we generally do business. This examination is done by analyzing the strategies with regard the Internet and Related technologies that were utilised by the countries ten independent banks from 2001 onwards. Specifically, how has the Internet impacted the United Kingdom's banking sector specifically the country's top 10 independent banks? As the scope of this study is limited to the ten British independent banks, and these banks annual reports to stockholders, the business strategies adapted by these banks in response to the Internet and related technologies are limited to what were published.

3.2 Research Hypothesis to be Tested

This paper is a review of the strategic responses of the United Kingdom's banking industry, specifically ten of the country's independent banks namely Barclays Bank, HSBC Holdings, Royal Bank of Scotland, HBOS, Lloyds TSB, Standard Chartered, Alliance and Leicester, Northern Rock, Co-operative Bank, and Bradford & Bingley, on the emergence of the Internet and related technologies. As such, unlike common research studies, this paper doesn't have null and alternative hypotheses to test using several statistical methods and tests.

In line with my main research question: How has the Internet impacted the United Kingdom's banking sector specifically the country's top 10 independent banks?, and with my methodologies, my hypothesis is that the banking industry adopted business strategies as response to the Internet and related technologies. Furthermore, I hypothesise that these adopted strategies fall under the extending the enterprise strategic play (the three information technology strategic plays are enhancing the business execution, extending the enterprise, and creating a new business opportunity).

3.3 Definition of Terms

The following terms and their definitions will be used throughout the remainder of the report.

Information Technology Strategic Plays

Enhancing the Business Execution: Involves a firm's use of information technology to improve, facilitate or redesign its business processes and operations.

Extending the Enterprise: Involves the use of information technology to extend a business organization's time, and market reach or geography.

Creating a New Business Opportunity: Involves a firm's use of information technology to create new business lines.

Business Strategy

Business strategy is a set of “managerial decisions and actions that determines the long-run performance of a corporation” (Hunger & Wheelen 1996, p. 3). Strategy management, on the other hand, is “the process of ensuring than an [organisation] possesses and benefits from the use of an appropriate [organisational] strategy” (Certo 2000, p. 167).

Independent Bank

An independent bank is a “locally owned bank that is operated without being affiliated with a bank holding company” (canequity.com). As such, a United Kingdom independent bank is a British owned bank rather than by a holding company.

3.4 Sources for the Data Used

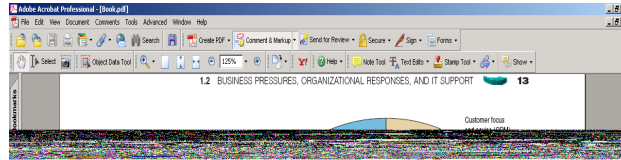
The ten banks’ strategies with regard the Internet and Related technologies were obtained from these banks’ annual reports to stockholders. These annual reports were obtained from the banks’ themselves through their Web sites and the London Stock Exchange. Several were also obtained from the British Bankers’ Association.

3.5 Sample Selection and Variables

3.5.1 Data Selection

Thompson acknowledged the interdependency of banks and its business environment. As such, banks continually adapt to their changing business environment. The environmental

business pressures and the corresponding organisational responses and IT support are shown in Figure 1.



Source: Turban, Leidner, McLean & Wetherbe 2006, p. 13

Figure 1 Business pressures, organisational responses, and IT support

As such, as changes in the banking environment are introduced, the Internet and related technologies are an example of technological pressure, banks respond in several ways. Vartanian, Ledig and Bruneau extrapolated that the “avalanche of technological developments that are changing the delivery of financial products and services will dramatically restructure the movement of information and the nature of money” (21st Century 1998, p. 88).

The United Kingdom’s banking industry is composed of different types of banks. The independent banks are those who are owned locally and not by holding companies. As such, this type of banks is the most appropriate to study in this paper because their business strategies are

not affected or dictated by an outside entity like their parent company or their international head office.

The period selected for this research paper is from 2001 to 2006. It is this period that the sample banks have their annual report to their stock holders available online. Some of the ten banks included in this study don't keep annual reports before 2001 in their Web sites. The period chosen is for ease and convenience for research.

3.5.2 Initial Processing

Step 1: The initial processing step will be to generate a list of all the strategies adopted by the ten British independent banks in response to the Internet and related technologies as published in their annual reports to stock holders for the last six years (2001 to 2006).

Step 2: Each of the strategies as listed above will then be classified into the three information technology strategic plays classification: enhancing the business execution, extending the enterprise, and creating a new business opportunity.

Step 3: The significance of the changes brought about by the strategies listed in Step 1 will be analysed. This is to check whether way the banks do business was greatly affected by these strategies.

3.6 Reporting of Results

Results will be presented using tabular formats.

3.7 Expectations

Table 1. Expected Results

Hypothesis Number	Bank	Expected Results
1	Barclays Bank	Extending the enterprise information technology strategic play
2	HSBC Holdings	Extending the enterprise information technology strategic play
3	Royal Bank of Scotland	Extending the enterprise information technology strategic play
4	HBOS	Extending the enterprise information technology strategic play
5	Lloyds TSB	Extending the enterprise information technology strategic play
6	Standard Chartered	Extending the enterprise information technology strategic play
7	Alliance and Leicester	Extending the enterprise information technology strategic play
8	Northern Rock	Extending the enterprise information technology strategic play
9	Co-operative Bank	Extending the enterprise information technology strategic play
10	Bradford & Bingley	Extending the enterprise information technology strategic play

CHAPTER 4 ANALYSIS AND PRESENTATION OF FINDINGS

4.1 Review of the Question

4.2 Description of the Data

4.3 Methods

The goal in this analysis is to determine whether the Internet has impacted the way banks do business in the United Kingdom. To analyze the data for this question, analysis of the specific strategies of ten banks with regard to the Internet and related technologies which were published through these banks annual reports was employed. These strategies were classified into the three information technology strategic plays. These three strategic plays are enhancing the business execution, extending the enterprise, and creating new business opportunity. By doing so, I was able to evaluate how significant the impact of the Internet and related technologies is on how these ten banks, and consequently the British banking sector, do business.

The first strategic play, “**enhancing the business execution**”, involves a firm’s use of information technology to improve, facilitate or redesign its business processes and operations.

A look at how people in some countries renew their driver's license before and how they renew it today will illustrate this strategic play. Previously, to renew a driver's license, one had to go to any of the authorized government agencies or any of the land transportation offices (LTO) as they are called in several countries, fill up the renewal form, and wait four to six months to get a new license card. Today, with LTO deploying IT systems such as digital scanners, photo printers, signature scanners, wide and local area networks, and other IT devices, getting the new license card can be completed in a matter of hours. IT had dramatically enhanced the business execution in this government office.

The second strategic play, “**extending the enterprise**” initiative, normally occurs in two forms, namely, extension in terms of time, and extension in terms of market reach or geography. The use of IT to go 24 x 7, such as deployment of ATM machines which provides virtually “always available” bank teller services, succinctly illustrates this extension in terms of time. On the other hand, the extension by market reach or geography can be accomplished by the availability of a website storefront that can be accessed anywhere by a firm's customers. In the travel industry, the deployment of website storefronts and electronic ticketing facilities now allow many airlines to sell to customers in remote locations that their traditional sales outlets and agents cannot easily reach.

Finally, the third strategic play, the “**creating a new business opportunity**” play, involves a firm's use of IT to create new business lines. This initiative requires organizational flexibility and risk-taking, a strong entrepreneurial spirit, and a much higher degree of business transformation than that required by the first two strategic plays. The dotcoms are businesses that have used IT to create new opportunities that were previously ignored or non-existent

before. Ten years ago, when you mention the word Amazon, one would most likely equate the word to the Amazon jungle. Today, Amazon.com is one of the leading online retailers, not only of books, but also music, office and electronic items. Closer at home, take a look at HSBC Holdings. Once just a bank in the corner, it has ventured into the convergence phenomenon and now has a string of successful subsidiaries and affiliates such as its virtual bank site that are almost all IT enabled and engaged in new business opportunities of the digital economy.

It is possible, and not unlikely, that banks examined in this research study would use a combination of these IT strategic plays in their efforts to support or shape their business strategies. The classification I have done shows this combination.

4.4 Results

4.5 Discussion

CHAPTER 5 CONCLUSIONS

5.1 Summary

5.2 Limitations of the Research

The scope of this study is limited to short-term period which is in contradiction to the meaning of strategy. Business strategy covers a period from three to five years, and a study utilising information created in a five-year period might result to an inconclusive research. It should again be acknowledge that this study focused on evaluating the impact of the Internet and related technologies on how British banks do business. This study doesn't attempt to establish whether the strategies adapted by the banking industry are successful financially or otherwise.

An important limitation I this analysis is the substantial amount of mission data and the relatively small sample size. Missing data can obscure trends in the data that might otherwise be observed. Furthermore, a relatively small sample size limits the power to detect a significant effect. If there were more observations to include in the analysis, there would be greater power to detect a relationship between the dependent and independent variables and the results might be somewhat different.

5.3 Recommendations for Further Research

There are a number of approaches in determining the impact of the Internet and related technologies on how the banking industry in the United Kingdom does business. There are even a number of approaches that can quantify this impact. The approach used in this study evaluates this impact by classifying the adapted business strategies into the three information technology strategic plays. Another approach can detail the strategies banks have adapted since the invention of the Internet, and track how these strategies affected the performances of the banks by trending profit and loss results, market share, and stock prices. By valuing or establishing the financial results of the changes in how banks do business as brought about by the Internet and related technologies, the importance of changing established business practices and strategies in response to the emergence of the Internet and related technologies is effectively quantified. This second approach creates an opportunity for further research.

Valuation, in relation to the changes in business practices and strategies in response to the emergence of the Internet and related technologies, is an area rich for further study and analysis. Comparable companies' valuation, for example, is a widely used commonsense approach based on the premise that similar companies should adapt similar practices and strategies. Key relationships are calculated for a group of similar companies and used as the basis for the valuation of the changes in business practices and strategies in response to the emergence of the Internet and related technologies.

5.4 Conclusion

TABLES AND FIGURES

Number the tables and figures consecutively for each chapter, e.g. number the first figure of chapter 2: 'Figure 2.1'. Position the legend below figures and above tables. Each figure and table should be self-explanatory. The reader should not be expected to search in the text for an explanation of a figure or the contents of a table. Tables and figures should be inserted into the text in the most suitable position, following the text referring to them.

APPENDICES

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