'Defunct' computer threatens to draw red line through Co-op bank profits

Katherine Griffiths

Annual profits at The Co-operative Bank could be wiped out this year because of a writedown of £200 million on an IT system that will become defunct if the mutual completes its acquisition of 632 branches from Lloyds Banking Group.

The Co-op is understood to have had the huge potential IT liability in mind when it hammered out initial terms with Lloyds in July last year, which were regarded by the market as remarkably generous to the mutual.

As part of the deal, Lloyds has agreed to hand over as much as £1.5 billion in equity capital to the Co-op, which is expected to use some of that to plug the IT spending hole.

The Co-op faces the liability because, after it bought the Britannia building society four years ago, it began an ambitious plan to replace its old IT system with a world-leading platform known as Finacle, designed by Infosys, of India. The upgrade has cost almost £700 million, according to one source, has yet to go live and is likely to be scrapped if the deal with Lloyds is completed, because the Co-op would use the bigger bank's IT system and pay a fee for that. The Manchester-based business is keeping Finacle on ice in case talks with Lloyds fall through.

It is understood that the Co-op has been able to salvage some value from the spending so far, leaving it with a bill likely to be about £200 million if Finacle is ditched.

The scale of the financial hit may surprise the stock market, given the Co-op's size. Its banking operation in its last financial year made a £201 million profit while the Co-op group, including its supermarkets and other businesses, made £373 million profit. The IT writedown is expected to appear in the annual results this year.

Lloyds is set to transfer 4.8 million customers to the Co-op, £24 billion in loan assets and the TSB and Cheltenham & Gloucester brands, as well as the 632 branches under the terms of the takeover. The two sides are expected to sign a formal sale and purchase agreement in the next two months, with a deadline for completion by the end of November. The full separation of the business will take much longer.

Questions have been asked in banking circles recently about the likelihood of Lloyds and the Co-op signing the agreement, with some pointing to concerns about IT and the difficulty of knowing whether customers will be happy to switch.

Lloyds has remained upbeat about prospects for completion. Britain's biggest retail bank is a forced seller of the assets, having been ordered to divest them by the European Commission in return for the bank and its partner HBOS receiving a bailout of £20 billion in 2008.

Confidence in such deals was shaken when a similar forced sale of assets by Royal Bank of Scotland to Santander, of Spain, fell through last autumn. Santander pulled out because of difficulties with IT and worries about customer relationships.

RBS has restarted the sale of its 318 branches but some specialists think that the bank is struggling to find a viable buyer before its deadline of the end of the year. The bank, 81 per cent-owned by the taxpayer, may have to pursue a flotation, instead. RBS is expected to ask Brussels for more time to divest the business but will delay its appeal until it is clear whether there is any prospect of finding a buyer.

● Handelsbanken is to open its 150th branch in the next fortnight, marking a dramatic British expansion for the Swedish lender (Sam Coates writes). The bank believes that it has identified a gap in the market, with branch managers making all lending decisions and no rejection of requests by centralised call centres, quotas on lending or risk models. *The bank's insistence on devolved decision making is so deeply ingrained that Anders Bouvin, the UK chief executive, does not know where the 150th branch will be until he is told by one of four regional managers a day or two in advance.*

Shoppers at Waitrose are increasingly avoiding the tills and doing their weekly food shop from the comfort of home

Supermarket rivals are sitting pretty in fight for the stay-at-home shopper

Marcus Leroux Retail Correspondent

Those perennial favourites of Middle England Waitrose and J Sainsbury are in pole position to reap the benefits of the burgeoning trend for buying groceries online, according to research.

A study by CACI, the location researcher, found that the two stores' customers were more likely to shop online and more likely to have broadband internet and a smartphone than those of other supermarkets.

The chains are also relatively strong in and around London, the region most under-served by physical supermarkets, as measured by grocery space per person.

An estimated 76.4 per cent of Waitrose customers have access to broadband, compared with 69.9 per cent of Asda customers. Only 13.4 per cent of Morrison's customers use a smartphone to access the internet, compared with 15.3 per cent of Sainsbury's shoppers.

The research does not show the potential for Ocado, the online grocer, because it is drawn from the physical catchment of stores.

Morrison's is the only Big Four supermarket group not to operate online. Dalton Philips, its chief executive, is expected to sketch out details of an entrance to the market this year.

Spending on groceries online will double to £11 billion in the next five years, according to a forecast by IGD, the food industry research body. It said that the introduction of 4G mobile phones should boost spending. Only 3.5 per cent of groceries are bought online at present.

Nicky Christie, from CACI, said: "Online and convenience are increasingly seen as the routes for growth as all the major retailers develop their offers and make them practical and cost-effective. With these strategies, the key groups to target are London and families due to their high internet access and growing propensity to shop online."

Asda and Tesco are opening "dark stores", online-only distribution centres that take some of the strain from their usual stores, to boost their online capacities. Both are also opening "click-and-collect" or drive-through areas in stores, allowing customers to pick up their orders already bagged.

Osborne 'must ditch his inflation target'

Sam Fleming Economics Editor

George Osborne has been criticised for taking a "timid" approach to boosting the economy, in a report that urges him to ditch the Bank of England's inflation target and embark on an aggressive push for growth.

The Ernst & Young ITEM Club accused British policymakers of displaying a lack of initiative in the face of a moribund economy, pointing to the United States as an example of what can be achieved if the correct levers are pulled.

Separately, Gerard Lyons, Boris Johnson's new economic adviser, has called for the Government to adopt a more positive message on the economy. Taxes should be cut as both fiscal and monetary policy are loosened to boost growth, the London Mayor's adviser wrote in an article published today in *The Times*.

Official data on Friday may show that the economy flatlined, at best, in the final quarter of 2012, with some economists saying that it slipped back into negative territory.

> **'It has become a risk to the Monetary Policy Committee's credibility'**
> Peter Spencer, ITEM Club

The ITEM Club argues that the Bank of England's 2 per cent inflation target is doing more harm than good and the Chancellor should scrap it. This comes after an intervention last year from Mark Carney, the Bank's incoming governor, in which he argued that central banks should sometimes target nominal gross domestic product.

The ITEM Club contrasted Britain's malaise with the situation in America, where the Federal Reserve has a dual mandate that involves both inflation and unemployment. The Fed has displayed flexibility, announcing unlimited purchases of residential mortgages and pledging to keep rates close to zero for as long as it takes to pull unemployment below 6.5 per cent or push inflation above 2.5 per cent. "The inflation target has now become a risk to the credibility of the Monetary Policy Committee and is long past its sell-by date," Peter Spencer, the chief economic adviser to the ITEM Club, said.

Time to think positive, page 33

City facing skills shortage

James Dean

The financial services sector will have shed 43,000 jobs over six months by the end of March, potentially leading to a skills shortage in the industry.

About 25,000 financial services jobs were culled in the last three months of last year — three and a half times more than expected — with another 18,000 forecast to disappear over the next quarter, according to a financial services survey from the CBI and PwC.

The estimates suggest that by the end of March, British financial services companies will have cut 132,000 jobs out of 1.1 million at the start of 2009. Nine banks in ten expect to make further cuts over the next three months, the research shows, although optimism in the sector is at its highest since 2004. It rose for the first time since March last year, as profitability improved unexpectedly in the last quarter.

Kevin Burrowes, the UK financial services leader at PwC, said that the UK banking sector was beginning to "get to grips with the sins of the past".

"Banks are facing a shortage of skills and a growing capital challenge," he said. "They expect the ability to raise finance to be a significant limitation on business during 2013. This implies that their upbeat predictions for growth could be undermined by an inability to commit sufficient capital to lending."

Fears over availability of expertise were at their highest since before the financial crisis. Graduates were less attracted to the sector and 40 to 50-year-olds were choosing to retire early.