

Rising to the Growth Challenge

A.T. Kearney's Financial Institutions Organic Growth Index, 2005



Regardless of size, focus or geographic footprint, financial institutions across the United States are stepping up efforts to improve their organic growth. The pressure is unmistakable: To achieve superior shareholder value, financial institutions must achieve organic growth rates of at least 6 to 8 percent annually, according to an A.T. Kearney study. The push to meet—and exceed—this threshold is equally striking: Our research reveals that virtually every financial institution in North America is aiming for organic growth rates of 10 percent or higher.¹ With such aggressive, if not unrealistic, targets in a mature, slow-growth market, financial institutions are in a highly competitive tug-of-war.

To win this competition, financial institutions must determine how to acquire new customers, capture the lion's share of their financial wallets, and then retain their business. Essentially, it requires a land grab that is only won at the expense of their closest and most aggressive competitors.

Winners in this struggle will be those firms that meet or exceed the standards for achieving organic growth. Which companies are setting the standards for organic growth? How are they doing it? Which companies need to catch up? Where are the hidden opportunities? To answer these questions, A.T. Kearney and Harris Interactive created a first-of-its-kind survey that looks at financial institutions through the eyes of their retail cus-

tomers. We surveyed more than 4,000 financial services retail customers in the 20 largest U.S. metro markets about their actual and intended behavior, their perceptions of their financial institutions and how they allocate their financial wallet (*see About the Study on page 12*). The products and services offered by the institutions in the index reflect nearly all consumer offerings.

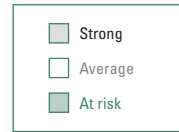
Based on this survey, we developed the Organic Growth Index, which assesses the relative organic growth potential of 31 financial institutions across the United States. The study covers the full spectrum of financial institutions—retail banks, diversified financial institutions and investment management firms.

¹ See, "Banks Shift Gears in Search for Top-Line Growth," at www.atkearney.com.

Overall, 31 financial institutions are ranked in this year's Organic Growth Index (see figure 1). These firms were selected by respondents as their primary financial institution, or PFI. We did not define the attributes of a primary financial institu-

tion for them or prompt them; rather, we wanted customers to choose an institution based on their own perceptions and on what matters most to them. A respondent could choose a primary financial institution based on the rate of transactions,

Figure 1
Organic Growth Index ranking



Index ranking	Institution	Overall score	Customer momentum	Wallet momentum
1	American Express	10.53	5.25	5.28
2	A.G. Edwards	9.75	4.83	4.92
3	Wachovia	9.68	5.11	4.56
4	Charles Schwab	9.64	4.81	4.83
5	Bank of America	9.33	5.36	3.97
6	Washington Mutual	9.26	5.47	3.79
7	PNC Financial Services Group	9.22	5.46	3.76
8	Charter One Financial	9.21	5.16	4.05
9	Smith Barney	9.17	4.33	4.85
10	Provident Bank	9.07	5.68	3.40
11	Chevy Chase Bank	9.07	5.34	3.73
12	Fidelity Investments	8.93	4.60	4.34
13	National City Bank	8.84	5.44	3.40
14	Union Bank of California	8.77	5.60	3.17
15	Citizens Banking Corp.	8.75	5.14	3.61
16	Commerce Bancorp	8.71	5.64	3.07
17	Wells Fargo	8.64	4.83	3.82
18	Standard Federal Bank	8.64	5.09	3.54
19	Merrill Lynch	8.63	4.43	4.20
20	Vanguard Group	8.61	4.64	3.98
21	Comerica Bank	8.56	5.10	3.46
22	Compass Bank	8.52	5.55	2.97
23	TCF	8.38	5.51	2.87
24	M&T Bank	8.01	4.82	3.19
25	SunTrust Banks	8.01	4.70	3.31
26	JP Morgan Chase	7.87	4.39	3.48
27	Citibank	7.81	4.24	3.57
28	U.S. Bancorp	7.78	4.50	3.28
29	Bank One	7.62	4.41	3.22
30	Fleet Bank	7.62	4.28	3.34
31	Sovereign Bank	7.06	4.31	2.76

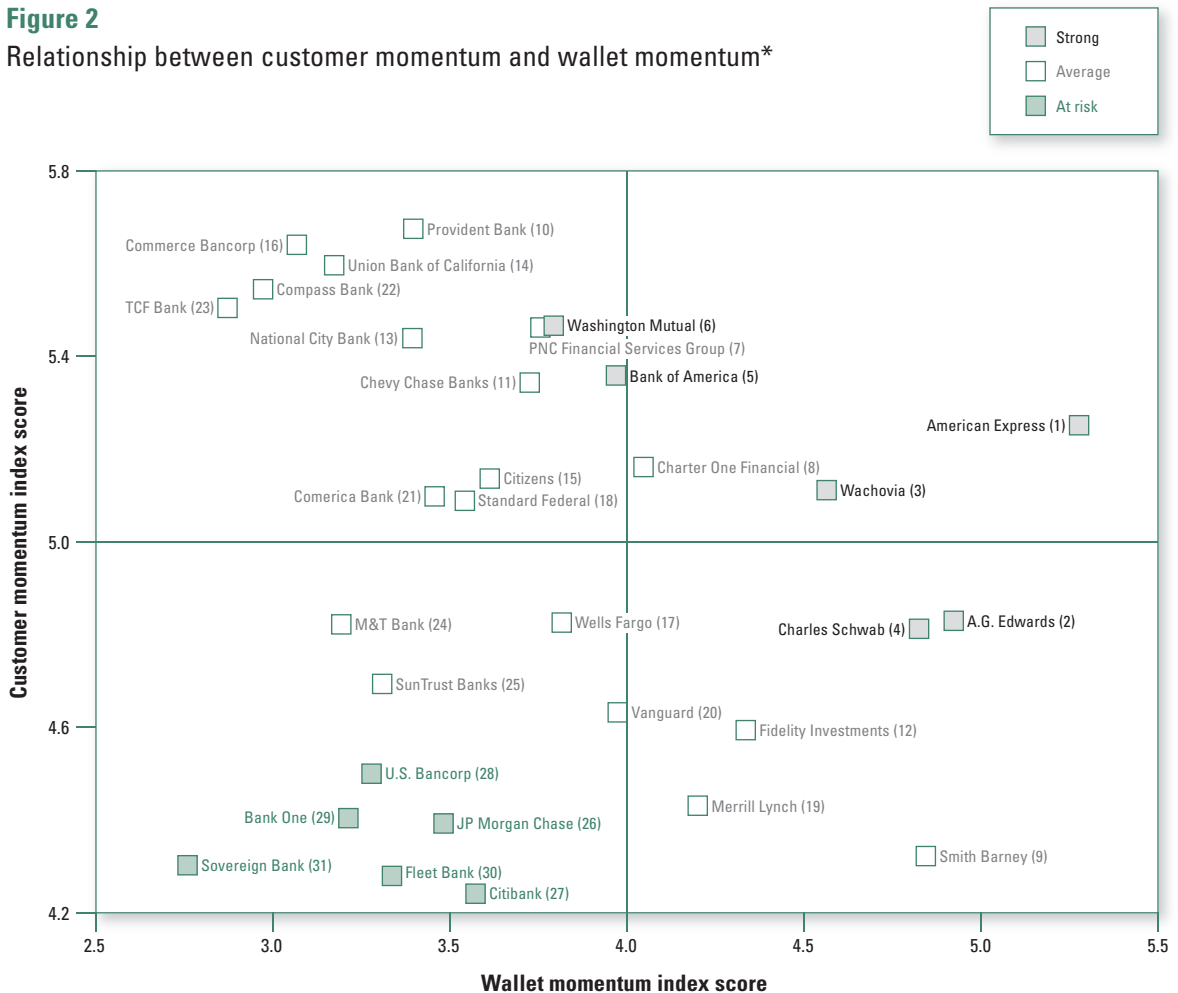
Source: A.T. Kearney

the number or type of individual accounts, the amount invested or even the amount owed.²

The index provides unique insight into which financial institutions have a strong hold on their customers as well as a significant portion of their personal balance sheets. As figure 2 illustrates, it measures both “customer momentum,” an institution’s ability to attract and retain customers, and “wallet momentum,” an institution’s ability to capture, retain and increase its share of customers’ assets and liabilities (*see sidebar: Defining Customer and Wallet Momentum on page 4*).

Our goal was to learn and explore the elements of organic growth. From the index, we identified the top six institutions in the United States. American Express, which captured the top position, is particularly strong in two areas—customer intent to increase account value and customer advocacy. Bank of America, Wachovia and Washington Mutual ranked strongest in quality of service. In addition, three of the top six—Charles Schwab, A.G. Edwards and American Express—hold more than 60 percent of their customers’ financial balance sheets.

Figure 2
Relationship between customer momentum and wallet momentum*



Source: A.T. Kearney

*Overall Organic Growth Index rank is indicated in parentheses

² To be listed on the index, a statistically significant sample of respondents had to name an institution as a primary financial institution.

The bottom six institutions in the index received poor marks in customer recommendations and in designation as a primary financial institution. For example, only 25 percent of

Sovereign Bank's customers and 35 percent of U.S. Bancorp's customers recommended each institution to others last year. Just 10 percent of Citibank's and Fleet's customers consider these

Defining Customer and Wallet Momentum

By connecting customer intentions and actions with wallet allocation decisions, the Organic Growth Index offers a unique glimpse into which financial institutions are best positioned to achieve organic growth and deliver superior shareholder value (see figure). Delving into each subcomponent of the Organic Growth Index provides a deeper understanding of what the index measures and the importance of each component.

Customer Momentum

Customer momentum indicates an institution's ability to attract loyal customers and forge long-lasting relationships with them. It includes four sub-components:

Primary financial institution (PFI) designation. Customers were asked to designate their primary financial institution. Without prompting, respondents chose their primary financial institution according to their own definition and what matters most to them.

Smaller retail banks boast high PFI designation scores, which strongly contribute to their high customer momentum scores. In fact, nine of the 10 banks that ranked at the top of the primary financial institution designation

are regional institutions.

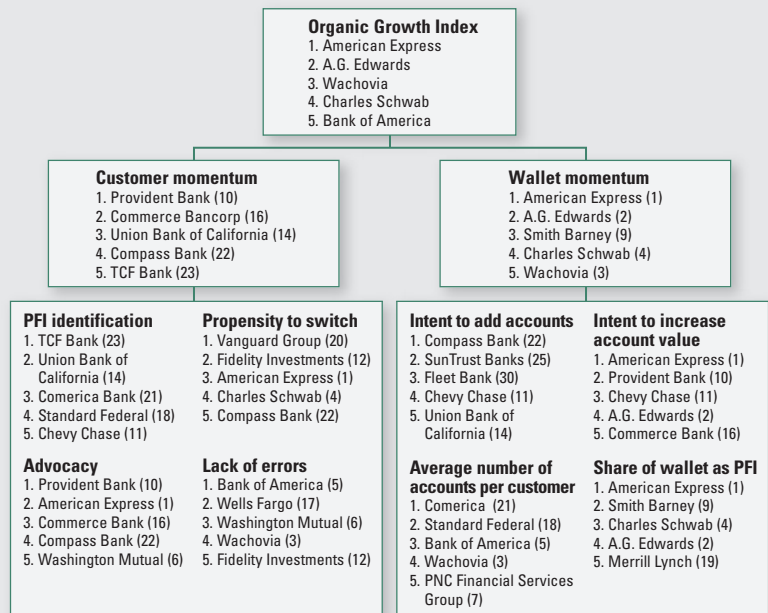
Leader: TCF Bank
Propensity to switch. The high cost of acquiring new customers underscores the importance of retaining existing ones. Because longer relationships drive increased customer profitability, customers were asked about the likelihood of switching their PFI within the next year.

More than 90 percent of customers do not intend to switch their primary financial institution.

Customers who consider investment management firms as their PFI are least likely to switch.

Leader: Vanguard Group
Advocacy. Word of mouth is a powerful means of attracting new customers. In determining customer advocacy, we examined if, and how often, customers recommended their financial institutions in the past year. On average, 53 percent of customers did so in the past year. However, the range varies from 26 percent on

Figure
 Top 5 institutions for each component and sub-component*



Source: A.T. Kearney

*Overall Organic Growth Index rank is indicated in parentheses

institutions as their primary financial institution. JP Morgan Chase's customers are among the most likely to switch financial institutions within the next year.

Increasing Organic Growth

The final analysis challenges some of the traditional thinking about the way financial institutions view organic growth. In particular, it reveals

the low end to 74 percent on the high end. Small retail banks had the most recommendations.

Leader: Provident Bank

Lack of errors. Customers were asked if they had experienced errors or service issues in the past year and what type of problem they had. When asked the primary reason for staying with their primary financial institution, customers overwhelmingly cite lack of errors or problems.

In the past year, 95 percent of customers said they did not experience a service problem or error with their primary financial institution. However, with two or more negative incidents, customer attrition rates are 35 percent higher than the industry average. And after three errors, attrition rates are more than double the industry average. Fleet and Charter One have the highest error rates in the index.

Leader: Bank of America

Wallet Momentum

Wallet momentum measures a financial institution's current share of wallet as well as customers' intentions to increase their wallet with their primary financial institution. We examine the amount of assets, liabilities and insurance products that customers have at various

financial institutions as a percentage of their total wallet.

Average share of wallet as a primary financial institution.

A firm's ability to capture a greater share of its customers' wallets is a measure of its ability to grow and maintain assets. Customers provided the dollar amounts in their accounts with their PFI and other institutions. We used this information to determine the average share of a customer's wallet held at the primary financial institution.

Investment management firms have the largest weighted average share of wallet, with the top six investment management firms—American Express, Smith Barney, Charles Schwab, A.G. Edwards, Merrill Lynch and Fidelity—holding, on average, more than 50 percent.

Also, customers clearly prefer to diversify their financial wallets; 75 percent of respondents have relationships with four or more financial institutions and 65 percent with five or more.

Leader: American Express

Average number of accounts per customer. Measuring the average number of accounts with the primary financial institution indicates an institution's success in cross-selling.

When asked how many equity,

debt and insurance accounts they have with their primary financial institution, most customers said one or two; the average was 1.7. The top 10 performers in this category are retail banks.

Leader: Comerica

Intent to add accounts.

Customers' intention to add accounts indicates a financial institution's ability to cross-sell to existing customers. We asked customers if they intend to open additional accounts with their primary financial institution in the next year. On average, just 22 percent said they plan to add accounts. Most said they would prefer not to consolidate accounts with one institution.

Leader: Compass Bank

Intent to increase equity account value. We examined an institution's ability to capture greater customer wallet share and gauged the amount of account leakage. Because most customers intend to reduce debt, the index focuses on their intention to increase equity accounts. On average, nearly 50 percent of customers intend to increase the balances of one or more of their existing equity accounts with their primary financial institution. No one type of institution performed better than another.

Leader: American Express

a select group of companies whose conscious pursuit of organic growth has allowed them to rank as “strong” performers in terms of customer and wallet momentum. It also reveals companies that are “average” or “at risk.” From our analysis, we arrived at the following:

1. Any company can take the lead

No single type of financial institution excels in *all* drivers of organic growth. In fact, the top six in the Organic Growth Index are a mix of retail banks, investment management firms and one diversified institution. While each of these top institutions performed well in at least two of the index’s subcomponents, their positions are not static. No one has achieved clear breakaway performance in the index.

In general, retail banks—smaller institutions, in particular—are better at creating customer advocates than investment management firms. However, investment management firms have “stickier” relationships with their customers. Overall, both groups have clear growth opportunities. To move into the prime upper-right quadrant, shown in figure 2, retail banks must build wallet momentum, and investment management firms must build customer momentum.

American Express’ overall strength helped it to capture the top position in the index. Buoyed by a strong brand and the service and asset management elements of its financial advisory unit, American Express is a leading performer in customer *and* wallet momentum.

However, ongoing consolidation and divestitures will likely continue to alter the competitive landscape. For example, it is unclear how the pending divestiture of American Express Financial Advisors, slated for late 2005, will affect American Express’ position in next year’s index.

Bank of America, which came in fifth on the

index, also ranks among the strong performers. But it faces challenges with its recent acquisition of Fleet. Although Fleet’s customer momentum scores are quite low, it ranks well above average on customers’ intention to add accounts. How well Bank of America manages the post-merger integration with Fleet will be a key factor in determining if Bank of America can maintain its high position on the index. Its newest deal with MBNA will also need further scrutiny.

2. Designation as a customer’s “primary financial institution” does not ensure success, but it helps

Institutions with the largest number of customers designating them as a primary financial institution do *not* necessarily capture the lion’s share of their customers’ wallet, nor do they produce higher levels of customer momentum. For example, on average, just 35 percent of a financial institution’s customers identify it as their primary financial institution. Yet, this designation is rarely linked to above-average wallet share; the weighted average share of wallet for a primary financial institution averages about 30 percent.

In other words, a firm can be a primary financial institution for most of its customers and still lack strong customer momentum. Conversely, a firm can be a strong performer and not be its customers’ primary financial institution. Consider A.G. Edwards. This full-service investment management firm came in second overall on the index, but it is not typically perceived as a customer’s primary financial institution. It is a strong player in terms of wallet momentum, particularly in increasing the value of its customers’ accounts. Yet without improving key elements of customer momentum—including capturing more customers who consider it their primary financial institution—its leadership position is vulnerable.

No single type of financial institution excels in all drivers of organic growth. The top six in the Organic Growth Index are a mix of retail banks, investment management firms and one diversified institution.

Although being designated as a primary financial institution is not a panacea, such designation is important because customers tend to conduct more transactions or have the majority of their money with their primary financial institution. When considering personal finances, customers naturally think first of their primary financial institution. This gives primary financial institutions a distinct advantage when cross-selling financial services, adding value to existing customer accounts and forging longer-lasting relationships with customers.

Some institutions leverage this opportunity better than others. In some cases, our findings underscore the importance of customer momentum—including a strong primary financial institution designation score—as a prerequisite for long-term success. Wachovia, for example, ranks third on the index. Its strong performance, in part, can be traced to the fact that nearly 50 percent of its customers consider it their primary financial institution. Also, 95 percent of Wachovia's customers have an average of two accounts and are not likely to switch to another firm.

In contrast, JP Morgan Chase and Bank One rank among the bottom six overall. Just 12 percent of JP Morgan Chase's customers and 16 percent of Bank One's customers consider each institution as their primary financial institution. Furthermore, JP Morgan Chase's customers are among the most

likely to switch institutions within the next year. Both firms, as a combined institution, have a chance to rank higher in the index by accelerating their customer momentum.

3. Although customers do not intend to switch financial institutions, they also do not intend to deepen existing relationships

Simply retaining customers is not good enough when it comes to meeting or exceeding organic growth targets. If financial institutions expect to come close to reaching or exceeding their growth goals, they have to expand their customer relationships (by adding new accounts, products or services) and increase the penetration of current products (by adding funds to existing accounts or increasing debt levels).

Most customers have just one or two accounts with their primary financial institution, and just 22 percent say they would add one or more accounts with that institution. On average, only about 50 percent of customers say they would add to the value of their existing equity accounts.

Average or at-risk performers that want to move into the strong performer quadrant could take a page from Charles Schwab's play book. One reason Charles Schwab is listed among the strong performers is because it has not rested on its laurels. That is why it is not surprising that Schwab's current focus is on cross-selling financial products

and increasing the equity account values of existing customers. It is developing Schwab Private Client, an advisory service for customers with US\$250,000 in assets, for fixed fees of US\$500 to US\$1,000. Schwab is also launching Schwab Bank, which will offer existing customers access to more traditional banking services. Most likely, this is how Schwab plans to keep a larger share of its customers' assets and thereby boost its organic growth potential.

4. No institution offers a compelling reason for customers to consolidate their financial relationships with one firm

Most customers still prefer to diversify their financial wallets among several institutions. On average, customers have relationships with four or more financial institutions. Even with their primary financial institution, customers are reluctant to add new products and services.

Most financial institutions have not been able to compel customers to consolidate their accounts with one institution, and few firms have been able to deepen existing customer accounts or prevent customers from shifting balances to another institution without closing their initial account. Clearly, strategies to cross-sell and increase existing account balances conflict with customers who remain reluctant to consolidate accounts with a single institution. A financial institution that can pull away from the pack and develop attractive value propositions for its customers will create the best opportunity to win customers away from competitors and cross-sell profitably to existing customers.

Washington Mutual is doing precisely that. This relative newcomer on the national scene ranks "strong" across the customer momentum component of our index. More than 95 percent of its customers do not plan to switch to a competi-

tor. But for long-term success, it must increase its wallet momentum, which can be accomplished by expanding its average number of accounts per customer. With its recent restructuring, Washington Mutual may be able to adapt more quickly to changes in the mortgage market and increase its cross-selling opportunities. This may also explain Washington Mutual's recent announcement that it is expanding into the credit card market and is refocusing its other offerings, such as depository services and distribution channels.

Overall, best practices and proven approaches for cross-selling remain elusive, with some institutions doing a better job than others. Customers of Wachovia and Bank of America maintain an average of two accounts with their bank.

5. Great service is essential to customer retention

Although factors such as product, price and convenience are important in attracting customers, the number one reason customers stay with a financial institution is "no errors or problems." Other reasons include consistently good customer service and rapid resolution of problems.

Because most institutions generally perform well in "quality of service," it is not a strong factor in creating competitive differentiation. However, maintaining a solid reputation is critical for attracting and retaining customers.

Preparing for Organic Growth

What must firms in the average or at-risk categories do to meet their organic growth targets? How can strong performers build on their current positions? In a dynamic market, the challenges of achieving organic growth will differ for each financial institution (*see sidebar: Tomorrow's leaders?*). Ultimately, all financial institutions must address both customer and wallet momentum

to meet their organic growth targets. Each firm's starting point—its unique mix of strengths and weaknesses—will drive different plans, priorities and actions. However, some lessons are common to all financial institutions:

Engage the front line

One secret to a lasting customer relationship is to provide customers with a consistently superior experience across all points of contact. This philosophy pertains to any industry that employs a distributed sales and service model, including financial services. Financial institutions need to engage branch and contact center professionals to build a unified customer experience model while addressing the significant variability of individual behaviors.

U.S. Bancorp is facing this challenge head-on. One reason why U.S. Bancorp falls into the at-risk category is because it suffers from low scores in both customer and wallet momentum. Only about 35 percent of U.S. Bancorp customers recommended it to others in the past year, and just

15 percent of its customers intend to add accounts in the coming year. This may explain why U.S. Bancorp is focusing more of its efforts on retail banking—especially on checking accounts—to improve customer relationships. It is investing in distribution channels in high-growth areas and plans to open more than 160 branches inside Safeway stores in California, Nevada and Arizona by 2006. If U.S. Bancorp can instill a unified customer experience across all points of customer contact, it could move up in the index.

Keep it simple

Although managing product and systems complexity has garnered significant attention (and respect) in other industries, it has yet to become a high-profile issue in the financial services sector. Many financial institutions have grown through acquisitions. The price for such acquisitive behavior is often increased complexity—numerous systems, products and services. Product complexity creates confusion for customers and employees, and it can have a significant impact

Tomorrow's Leaders?

Among the financial institutions that did not rank in the top tier of the index are several new challengers. By focusing on improving key areas, they could make a strong jump up the index ranks.

Among retail banks, Commerce, Provident Bank and Union Bank of California excel at customer acquisition and retention but still need to focus on achieving wallet momentum. Similarly, Charter One scored relatively high in customer acquisi-

tion and wallet share, making it a top 10 player, but it could work on its customer retention score.

The question is, how will the recent acquisition of Charter One by the Royal Bank of Scotland affect its position on the index? Likewise, Compass ranks high in customer momentum and could exploit this edge to increase its wallet momentum. Finally, PNC stands out in its ability to acquire customers, but it needs to focus more on build-

ing stronger relationships once customers are in the door.

Among investment management firms, Smith Barney scores exceptionally well in wallet share. When it does a better job attracting and retaining customers, it will be a strong competitor. Also, investment management firms Fidelity and Vanguard have the highest customer retention scores and strong wallet share but still struggle with customer acquisition.

All financial institutions must address both customer and wallet momentum to meet their organic growth targets. Each firm's starting point—its unique mix of strengths and weaknesses—will drive different plans, priorities and actions.

on product costs, which can harm profitability. It is also one reason why firms spend so much time and money on training and retraining employees, educating customers and processing transactions. Ultimately, complexity has a negative effect on customer satisfaction because it increases the potential for errors.

By better managing and streamlining their product and service portfolios, financial institutions can differentiate their businesses from their competitors (in terms of delivery and product pricing) while improving margins.

Redefine the value proposition

Institutions that boast top scores in customer momentum are in an enviable position: They can deepen their customer relationships and capture more of their customers' wallets by cross-selling new products and services and increasing the value of existing accounts.

Sounds simple enough. However, these are difficult strategies for most financial institutions to employ because most institutions are organized in product "silos," which effectively inhibits cross-selling. Sales and support functions are organized around products rather than customers, so improving customer service is difficult. Because products and services are not integrated, custom-

ers that have multiple products with the same financial institution often feel like they are doing business with several different institutions.

Financial institutions have generally failed to convince their customers of the value—in both convenience and economics—of building a deeper relationship with one institution.

To address this issue, financial institutions must look at products and services through the "lens of the customer" and organize around customer needs rather than product silos. This requires understanding what customers truly value (current customer segmentation schemes are not always meaningful) and defining a better competitive framework for different products. Translating this understanding into a compelling value proposition that focuses on the convenience and economics of consolidating accounts with one institution is essential to a firm's organic growth. It will not, however, necessarily compel customers to deepen their existing relationships. Financial institutions must also educate and sell their customers on their new value propositions and improve delivery.

Building Momentum for Tomorrow

Over the past few years, the financial services industry has enjoyed high rates of revenue

growth—but the bulk of this spurt is a result of mergers and acquisitions. Now is not the time for a false sense of security. Faced with a fiercely competitive market and a mature industry, financial institutions must shore up all facets of their growth strategies. In other words, to achieve a strong and enduring competitive edge, firms must balance *both* acquisitions and organic growth.

By connecting customer attitudes with their actual behavior to measure the drivers of organic growth, our Organic Growth Index provides insight into the relative performance of financial institutions. In this dynamic market, it is anyone's game to win. By filling performance gaps and building on strengths, even vulnerable financial institutions can accelerate their momentum against the leaders.

About the Study

A.T. Kearney's Organic Growth Index is based on findings from a survey of more than 4,000 adults who hold accounts with financial institutions in the 20 largest U.S. metropolitan markets. Data was collected in late 2004 by Harris Interactive® on behalf of A.T. Kearney.³

Survey questions were intended to obtain information from financial services consumers about their current and future wallet allocations, loyalty to their primary financial institutions, and criteria for selecting and staying with a financial institution.

Based on the survey results, we developed a weighted, composite score for each institution based on the following components and supporting elements:

- Customer momentum: advocacy, primary financial institution identification, propensity to switch institutions, lack of errors
- Wallet momentum: intention to add accounts, intention to increase equity account value, share of financial wallet with primary financial institution, average products per customer

Each financial institution received an absolute rank and a performance categorization.⁴ Results for the 31 institutions with a statistically significant sample size are reported in the Organic Growth Index and include banks, diversified institutions and investment management firms.

³ Overall results have a sampling error of plus or minus 1.4 percentage points.

⁴ One standard deviation above the mean, within one standard deviation of the mean, or one standard deviation below the mean.

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A.T. Kearney, Inc.
Marketing & Communications
222 West Adams Street
Chicago, Illinois 60606 U.S.A.
1 312 648 0111
fax: 1 312 223 6759
email: insight@atkearney.com
www.atkearney.com

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