# Strategic Report

Lead Partner: J.R. Hall
Consulting Partners: Matthew Noerper
Jamie O'Brien

PAConsulting
Perception ▪ Analysis ▪ Communication

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# Background

## History

Wells Fargo and Company (NYSE: WFC) is a diversified financial services institution, offering products from savings and checking accounts to home mortgages and insurance. It became the institution we know today through a merger with Norwest Bank in 1998. Due to the extensive history of the Wells Fargo stagecoach, it was no surprise that the Wells Fargo name remained after the merger in order to utilize brand-name recognition. The merger was attractive for several reasons; the most important of which was the complimentary regional coverage, allowing for expansion into the Midwest. Expected cost savings were roughly $650 million. The bank's geographic expansion mirrored the future business plans of financial product expansion.

Today Wells Fargo manages over $390 billion in assets with a market capitalization of nearly $98 billion. Due to the latest merger between JP Morgan Chase and Bank One, Wells is now the 4th largest bank in asset value. While Wells Fargo's consumer finance and home mortgage services encompass all 50 states, Wells Fargo Banks span only the West and parts of the northern Midwest. This leaves plenty of room for future geographic expansion, however, Chairman and CEO Dick Kovacevich remains cautious about a blockbuster merger, noting he would rather stay externally focused on customer service than devote resources to curing the internal problems often created by merging.

## Products

Wells Fargo has 10 strategic initiatives it has used to gauge its progress over the past six years, the most important of which have to do with cross-selling. The company's goal is to have each customer hold 8 financial products with Wells Fargo. While the 4.2 household average for 2002 was well above the two for most competitors, it remains well short of the target. Because the average U.S. household has 15 total financial products, the company believes the 8 product threshold is quite reasonable.

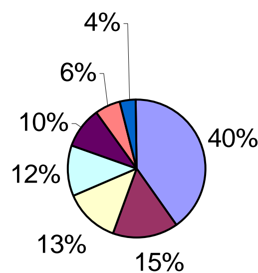
Many of the financial products Wells Fargo offers come together online, where the company has successfully spear-headed its cross-selling strategy. Here, customers can pay bills, check statements, track investments, and manage each Wells Fargo product they own. Wells leads the financial services industry in e-commerce processing. In 2003 Wells accounted for 15% of the nation's total online shopping volume through secure online payment services and ease of sales reporting. This volume stems from

processing payments for nearly 99 percent of Ebay auctions as well as over 60,000 other online merchants. Wells Fargo's Business Online Banking for small business owners makes many of the financial operations accessible and easy to use. Its programs have reduced the necessity of geographic proximity to a financial services institution. However, the company still prides itself on face-to-face interaction and distinguishes itself from competitors through higher levels of customer service.

## Industry

The ratification of the Gramm-Leach-Bliley Act in 1999 changed the landscape of banking, and set Wells Fargo on its path to diversification. The Act permitted American banks to expand beyond merely collecting deposits and writing loans. Focused on acquiring and retaining customers through a continuous cross-selling process, Wells Fargo relies on economies of scope to build and maintain its client network. It continues to acquire a variety of financial service firms and lead the industry in online services. It purchased Acordia in 2001 to fortify its leadership in the insurance brokerage industry. Most of its fifty-plus acquisitions since the merger include community banks and mortgage portfolios, as well as Seattle brokerage firm Ragen MacKenzie, and Dallas financial planning firm H.D. Vest. It has also expanded its investment product portfolio by purchasing dozens of mutual funds. Wells Fargo's business is comprised of the following:

**Profit Breakdown**

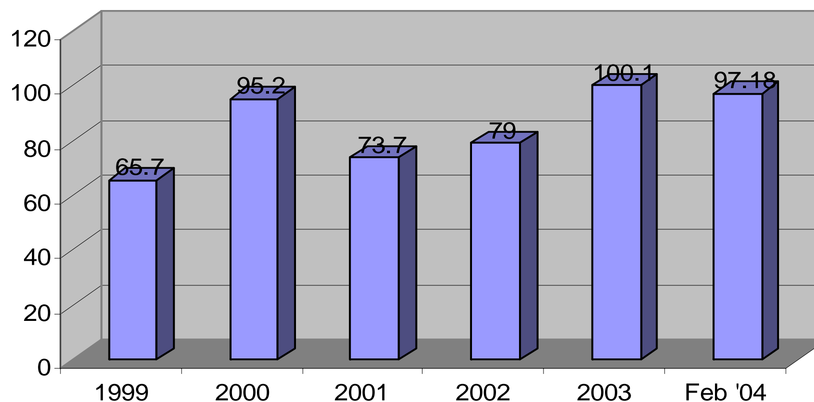



Community Banking
Investments & Insurance
Home Mortgage/Home Equity
Specialized Lending
Wholesale Banking
Consumer Finance
Commercial Real Estate

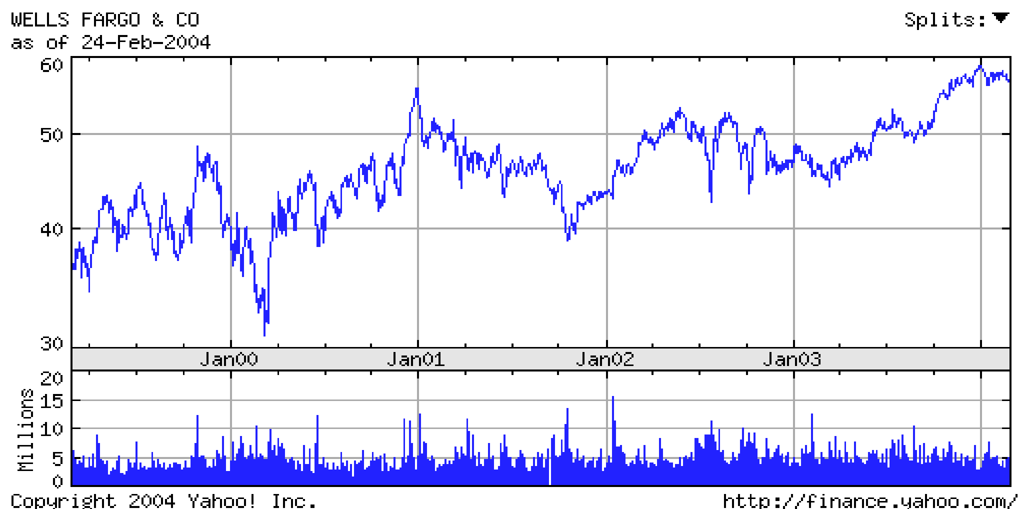
# Financial Analysis

## WFC in the Marketplace

Wells Fargo & Co. has exhibited steady growth in market capitalization over the past 3 years. The jump in 2000 can likely be attributed to the internet boom, as Wells Fargo was the first financial services institution to offer online banking and bill pay. While it continues to lead the industry in this area, much of the hype surrounding internet services has diminished since then. Most of the growth stems from the steadily rising stock price, as the number of shares outstanding remained fairly constant. Because the P/E ratio has remained fairly low (hovering around 16), the rising price doesn't suggest speculation or high overvaluation.




## Stock Price



## Income Statement Analysis

Despite its status as a financial services institution, Wells Fargo still functions quite similarly to a bank and receives income from either interest sources such as loans and mortgages, or noninterest sources such as service fees and insurance. Net Income increased over 50% from 2001 to 2002, riding gains in noninterest income and cuts in interest-related expenses. The income from mortgages for sale increased by 53% from 2001 to 2002. This stems predominantly from refinancing activity and increased originations. However, these gains were partially offset by a slowdown in commercial loans because of the struggling U.S. economy. When the new numbers come out though, they will likely show strong growth for 2003. The promising figures come from a 10% increase in average core-deposits, which is the company's low-cost source of funding. This increase spread the net interest margin and paved the way for overall interest income growth.

In addition to growth in net interest income, overall interest expenses also fell by over 40% due to significant reductions in deposits, short-term borrowings, and long-term debt. The increased noninterest income has stemmed from strong jumps in credit card fees and loss reductions in equity investments. The total number of credit card accounts increased, as well as usage and merchant fees on debit and credit cards. As mentioned before, Wells Fargo processed over 15% of electronic transactions over the internet in 2003. Service fees on deposit accounts also increased because of the additional activity. As the company continues to expand services to its customers, these numbers will likely follow the same trend.

## Balance Sheet Analysis

Wells Fargo & Co.'s assets increased from $307 billion in 2001 to $349 billion in 2002. Most of this was due to the income gains previously mentioned. However, the increase was partially offset because of a drastic reduction in Securities Available for Sale. This is due to "a decrease in federal agency securities from the sale of certain longer-maturity mortgage-backed securities subject to prepayment risk and prepayment of mortgage-backed securities held" (2002 Annual Report, 71). On the liabilities side, total liabilities increased with the growing number of both interest-bearing and noninterest-bearing accounts. There was an 11% decrease in short-term borrowings, as the bank shifted its position by acquiring more long-term debt. Because of this move, long-term debt increased nearly 30%.

Total shares outstanding decreased from 2001 to 2002, but jumped back up this past year as Wells continues to acquire smaller business to expand the variety of financial products. There were no mergers or acquisitions on the scale of the recent wave of mega-mergers such as Bank of America/Fleet Boston and JP Morgan Chase/BancOne. Were the company to make such a move in the financial services industry, it remains unclear whether it would finance the move through debt or equity. Based on the company's solid financial position, it might be inclined to increase long-term debt as long as double-digit growth is maintained.

## WFC vs. the Financial Services Industry (2002)

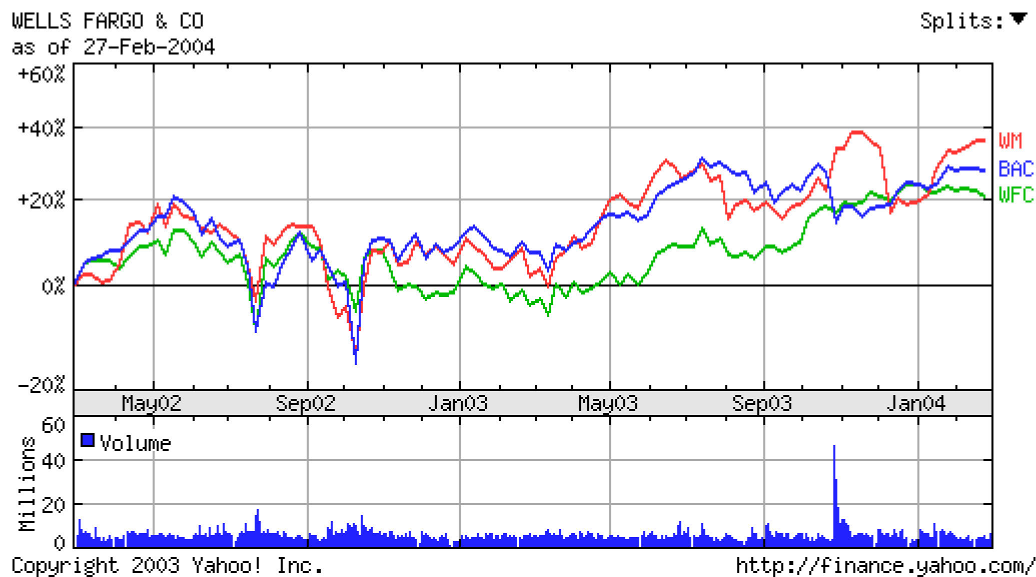
| **Key Numbers** | Wells Fargo | Bank of America | U.S. Bancorp | Washington Mutual |
|---|---|---|---|---|
| Annual Sales ($mil.) | 28,473.0 | **46,362.0** | 14,571.0 | 18,013.0 |
| Employees | **134,000** | 133,944 | -- | -- |
| Market Cap ($mil.) | 96,259.5 | **120,855.4** | 54,062.8 | 40,200.4 |

| **Profitability** | Wells Fargo | Bank of America | U.S. Bancorp | Washington Mutual | Industry[2] | Market[3] |
|---|---|---|---|---|---|---|
| Gross Profit Margin | -- | -- | -- | -- | -- | 47.89% |
| Pre-Tax Profit Margin | 30.43% | 31.00% | **38.64%** | 35.50% | 23.22% | 5.34% |
| Net Profit Margin | 19.84% | 22.01% | **25.62%** | 21.54% | 16.47% | 2.43% |
| Return on Equity | 18.7% | **21.2%** | 19.2% | 19.0% | 16.0% | 4.9% |
| Return on Assets | 1.5% | 1.5% | **2.0%** | 1.4% | 1.2% | 0.8% |
| Return on Invested Capital | 6.4% | 9.2% | 7.3% | **11.1%** | 6.6% | 2.4% |

Wells Fargo's profit margins remain healthy, several points above the industry average. Even though it may not lead, the company remains competitive with the top performers in this area. Wells Fargo differentiates itself through higher standards of customer service, rather than the lowest fees and rates. Thus, the larger profit margin comes as no surprise. The ROA and ROE are slightly lower than the competition, but still above the industry average. In addition, Wells Fargo has a total debt/total capitalization ratio lower than many competitors with the same relative ROE. This translates into a healthy financial position and makes the company an attractive stock purchase.

| **Valuation** | Wells Fargo | Bank of America | U.S. Bancorp | Washington Mutual | Industry[2] | Market[3] |
|---|---|---|---|---|---|---|
| Price/Sales Ratio | 3.16 | 2.49 | 3.71 | **2.23** | 2.63 | 1.47 |
| Price/Earnings Ratio | 15.98 | 11.62 | 14.52 | **10.62** | 16.20 | 63.29 |
| Price/Book Ratio | 2.98 | 2.40 | 2.78 | **1.97** | 2.55 | 2.96 |
| Price/Cash Flow Ratio | 15.94 | 11.30 | 14.60 | **9.98** | 16.05 | 16.85 |

Washington Mutual's advantage in profitability ratios likely stems from a steep drop in the stock price during the 4th quarter of 2002. Wells Fargo's stock price fell as well, however, it tends to fluctuate less than that of Washington Mutual. Because of Wells Fargo's strong financial position and reputation for prioritizing shareholders, its valuation ratios may be slightly distorted upwards.




| **Financial** | Wells Fargo | Bank of America | U.S. Bancorp | Washington Mutual | Industry[2] | Market[3] |
|---|---|---|---|---|---|---|
| Leverage Ratio | 12.09 | 14.63 | **9.72** | 14.02 | 13.41 | 6.06 |
| Total Debt/Equity | 2.73 | **2.15** | 2.29 | 2.85 | 2.14 | 1.46 |
| Interest Coverage | **3.60** | 2.40 | 3.50 | 2.30 | 2.00 | 1.90 |

[2] Industry: Money Center Banks
Industry classifications are from Media General Financial Services, Inc. .
[3] Public companies trading on the New York Stock Exchange, the American Stock Exchange, and the NASDAQ National Market.

While Wells Fargo may not lead all competitors in these areas, its numbers remain significantly higher than the industry average. As mentioned earlier, Wells Fargo remains in good financial position in terms of low debt. The company remains the only financial service company with a Moody's rating of "Aaa." Many analysts retain a 'hold' suggestion on the stock, as Wells Fargo continues to look out for its shareholders by offering significantly higher dividends than its competitors.

## Porter's Five-Forces Analysis

### Internal Rivalry

An internal rivalry analysis of the banking industry may be broken down into two primary components, the retail banking and commercial banking industries. While many banks sell products and services in both markets, there are some that cater solely to one market. Because Wells Fargo is involved in both industries, it must compete with both commercial and retail banking operators.

It is important to note that the banking industry as a whole has come to be defined as increasingly vertical in organization over the past few years. The Financial Services Modernization Act of 1999 has spurred the consolidation of what used to be separate banking operations – and several players took advantage of the economies of scope derived from providing a diverse array of financial services under one entity. Recent mergers of the past several years include JP Morgan - Bank One, Wells Fargo – Norwest, and Bank of America - Fleet Boston. Thus, the competitive landscape has been transformed considerably and is much more fluid than before the enactment of this piece of legislation. However, analysts do not predict significant M&A activity in the near future within this industry until the pricing discipline of buyers and sellers converges. In other words, when sellers demand lower prices and buyers offer higher prices.

### *Retail banking*

Catering primarily to lower middle to middle class consumers, Wells Fargo's primary competitors in this sector are Bank of America, U.S. Bancorp, and Washington Mutual. However, the competitive landscape is populated with many others including Bank One, Golden West Financial, Household International, and UnionBanCal. With hundreds of branches geographically spread throughout most of the West Coast, these institutions all offer products such as deposit accounts, loans, insurance, and asset management services to consumers and businesses.

In times of low interest rates, such as today, people tend to move their money out of banks and into the stock market, where they can potentially earn a higher return. While Wells Fargo does offer brokerage services, customers tend to look towards more publicized names like Morgan Stanley and Merrill Lynch for asset management. Wells has pumped a lot of money into developing their Private Client Services and has a goal of double-digit net income growth from that area within the next three

years. In order to do this, we believe it will take more publicity and a stronger push from the cross-selling end.

Recently there have been trends towards the offering of a wider array of financial services in an effort to realize economies of scope – once the infrastructure is set up for a couple basic financial services such as mortgages and savings accounts, setting up money market accounts is inexpensive relative to the expected benefits in increased exposure, revenues, and buyer switching costs. This is also a response to fringe competition from non-banks such as mutual funds, securities brokers and dealers, and credit unions, which all compete for consumer capital.

The aforementioned factors also justify the aggressive cross-selling strategies designed to not only increase product sales, but to also increase customer loyalty and buyer switching costs. The marginal cost of selling a credit card to a customer who recently opened a deposit account is minimal in comparison to the benefits of realizing that sale. The selling of homeowner's insurance coupled with mortgages is another prime example.

Wells Fargo prides itself on its excellent customer service, which is a primary area of strength as it strives towards the goal of realizing eight financial products per customer. This is key for the company because unlike key competitors such as Washington Mutual who attempt to attract customers with product differentiation, i.e. no-cost checking accounts, Wells Fargo relies primarily upon differentiation through superb customer service.

Along these lines, while firms are able to differentiate themselves through non-price means, they are limited in their ability to do so through pricing mechanisms. While Washington Mutual is able to attract customers with no-cost checking accounts and free ATM access, it charges above-average overdraft penalties. Interest rates on financial products typically reflect macroeconomic interest rates. Given that most of the key players in the industry protect their customers with FDIC insurance, a bank's insured financial product is typically not inherently superior to another's in terms of risk.  Therefore firms rely not only on non-price mechanisms such as customer service and increasing switching costs through cross-selling, but also through geographic dispersion. While all major players within the industry have well-established 24-hour internet banking access, consumers still prefer to initiate accounts via traditional face-to-face interactions. This has been made apparent by the sheer magnitude of geographic bank dispersion. With 3021 community banking stores located in 23 states, Wells Fargo has been able to

establish itself as a leader when it comes to retail banking cross-selling, small business lending, home equity, and home mortgages. Primarily operating out of the west and Midwest, its strongest presence exists within the states of California (813 stores), Texas (503 stores), Nevada (105 stores), Oregon (127 stores), Washington (123 stores), New Mexico (106 stores), Colorado (126 stores), Minnesota (179 stores), and Arizona (229 stores).

### *Commercial Banking*

The biggest competitors in the commercial banking field are easily Bank of America/Fleet Boston and JP Morgan Chase/Banc One. Whereas Wells Fargo earns the largest portion of its income from retail banking, these two banks deal primarily with large commercial accounts. Wells Fargo's fledgling investment banking division has also struggled to compete with these banks as well as well-known investment banks like Goldman Sachs, Morgan Stanley, and Merrill Lynch. These banks can build markets for clients that want to issue securities instead of taking out loans, whereas Wells Fargo's investment banking branch does not yet have the network of customers needed to execute such a transaction. The commercial and investment banking fields are more fragmented than the retail banking sector. There are many smaller investment banks that specialize in mergers & acquisitions as well as advisory investment services. Wells Fargo has limited its involvement in this area and remains primarily focused on community banking and home mortgages.

Just as in retail banking, cross-selling plays an important role on the commercial side as well. Tools such as Fed money wires, online Commercial Electronic Office, and Payroll Services all complement each other. By offering a superior blend of products instead of specializing in just one or two areas, Wells Fargo continues to differentiate itself and retain its commercial customers. Again, as the number of financial products a company purchases increases, the switching costs of using another bank or adding services outside of Wells Fargo also increases. Wells Fargo offers price breaks to commercial customers who utilize several of their financial services. While the company continues to pump money into expanding its commercial resources to compete with larger nation-wide commercial banks, commercial cross-selling looks to be the backbone of Wells Fargo's strategy in the future.

One last aspect of the banking sector to keep in mind for both the retail and commercial sides is that of interest rate risk. A bank needs to manage its long-term and short-term assets and liabilities wisely to avoid susceptibility to losses when interest rates fluctuate. As interest rates rise, more people deposit

their money into bank accounts, increasing bank liabilities. If a bank issues too many loans (assets) at low interest rates, it will suffer asset/liability mismatch when rates rise. This causes banks to receive income from low-interest paying assets, while paying out on higher-interest liabilities. However, interest rate swaps is one of many ways of hedging against this risk, and because bank managers constantly have an eye on current and projected interest rates, the problem rarely arises outside of banks already in tough financial positions.

## Entry

The barriers to entry in the banking industry are fairly substantial. Due to government regulations, continuous assessments, and the growing number of mergers, newcombers face steep initial costs and intense competition from large country-wide banks. At this time there is not a high degree of economies of scale for larger banks. Most of the money-saving techniques occur through economies of scope instead. Recent geographic expansion stems from banks merely searching for more customers rather than reducing per customer costs.

When an entity wishes to create a commercial bank, the must obtain a charter from the Comptroller of the Currency (for national banks) or the state banking authority (for local banks). The body must complete an application detailing plans for managing the bank. If the charter is passed, the bank is subject to quarterly call reports that assess assets, liabilities, income, ownership, etc. as well as annual regulatory assessments. This is to ensure solvency and to some degree protect the customers of the bank. The government has no tolerance for mismanaged banks, so managers must know the industry very well in order to start up their own bank. The amount of knowledge needed to comply with regulations places a sizeable barrier on a firm's ability to enter the banking market.

In this evolving environment of top-heavey market share, brand recognition will start to become more important. Currently people recognize different names, but shop for financial services primarily on price. However, as the number of financial services companies diminishes, brand recognition and product differentiation will play a more significant role. This plays well into Wells Fargo's hands because the company already distinguishes itself through higher quality customer service. We believe that a firm entering the market in the future will face greater difficulty attracting customers based on brand recognition.

A final substantial barrier to entry is the incumbents' advantage from a large installed base of customers and infrastructure. As banks look to capitalize on economies of scope, large-scale customer networks become crucial to profitability. A firm can more easily push new products onto its established core of customers, rather than hinge success on new client attraction. For a bank trying to enter the market, establishing an initial large customer base is difficult, and will only get harder as the largest banks swell even further.

## Substitutes and Complements

Substitutes and compliments play a large role in the banking industry due to the aforementioned economies of scope. Financial services institutions offer a plethora of products to help people smartly manage their money. There are many products that can maximize wealth, but they may offer different rates of interest or varying time and withdrawl requirements. An ATM card is a classic complement to a standard checking account. Home insurance can easily be considered a complement to a mortgage. The list goes on, but in general the complements are priced cheaply enough to attract customers into packages of products. This is the essence of cross-selling, which feeds off economies of scope.

The key to successful cross-selling is to price complements at an attractive level, but high enough to maximize switching costs. As people acquire more financial service products, the cost of switching banks or existing products increases as well. Thus, substitutes from opposing banks become less threatening as a company keeps a firm grip on its customers. As the number of mega-banks increases, this pattern will continue so that complements become significantly more important and substitute power diminishes.

Possible substitutes such as mutual funds and credit unions continue to steal away possible clients on the retail side, but their power is relatively small and narrowly focused. Credit unions offer a higher degree of customer service than most banks because of their smaller size and community-ownership. However, customers must pay a premium for these services. In the current low-interest rate environment, mutual funds have become more attractive because people look more to the market for a higher return on assets. With probable interest rate hikes in the near future, people may move away from those substitutes and back into traditional banking assets such as savings and money market accounts.

## Supplier Power

Supplier power in the banking industry is virtually non-existent because of the lack of a supply chain. We would hypothesize that infrastructure costs, such as managing software, online servers, and check-processing machines are sold at prices determined by the market, but thus far we have not been able to contact anyone that may possess this information. Due to the unique nature of infrastructural products, there might be some supplier power, but there are likely numerous companies that sell check-processors. The possibility of in-house software development also exists, so suppliers are unikely to try to price discriminate between buyers. Thus, supplier power may exist, but it is relatively weak in the banking industry.

## Buyer Power

Banking's retail/commercial dichotomy truly comes into play when determining the amount of buyer power. The average customer on the retail side has little ability to change the prices offered by the bank. One cannot haggle over the interest rate on a savings account. However, the transaction process on the commercial side is quite different. Here, clients must first issue an RFP, or 'Request for Proposal.' This specifies the products and services desired by the potential commercial customer. Such requests could range from treasury management products to online account management programs to payroll services. After the potential client issues RFPs to various banks, those banks return to the client with proposals for business. Essentially, the banks place bids for the customer's business, and the client decides which offer looks the most appealing. Thus, the commercial side of the bank faces heavy buyer power. The bank must pay close attention to each client's individual needs in order to secure business and create revenue. When it comes to commercial accounts, banks are more price takers, whereas on the retail side, the bank is a price setter.

## Evaluation of Key Issues

### Issue One – Rising Interest Rate Environment

Recently, the Department of Labor announced both a rise in American employers' payrolls and a fall in the number of first-time claims for unemployment insurance. The surprisingly large drop brought the number of new claims down to its lowest number since President Bush took office. As the 'jobless recovery' seems to be transforming into a steadily-improving employment environment, the Fed will likely use this as an excuse to slowly raise interest rates again to fight potential inflation. Rising interest rates cause varying degrees of difficulty for banks as retail clients and businesses become less inclined to borrow. For Wells Fargo, a bank that heavily relies on the origination of residential mortgage loans, rising interest rates can have a significant effect on the bottom line. Both originations and refinancings will decrease as the Fed raises their target rates. Thus, the company must position itself to hedge against this risk and begin to rely on income streams from other financial products.

### Issue Two – Importance and Improvement of Cross-Selling

As ability to maintain the origination of residential mortgage loans decreases, Wells Fargo's cross-selling strategy becomes even more important. However, the company has had some problems with cross-selling effieciency due to the autonomy of many service departments and the integration of complex prodcts into the financial services pipeline.

The main areas of Wells Fargo, such as Personal Banking, Corporate Insurance, and Private Client Services are referred to as "silos," because they essentially conduct business on their own and don't report to a common entity. The company stresses the importance of differentiation because it allows bankers to specialize in their area and build a stronger knowledge base. Thus, in order for the cross-selling strategy to work efficiently, employees must refer their customers to co-workers on other departments. The company creates incentives directly, through immediate financial compensation to referring departments, as well as indirectly, through performance evaluations. While the focus on specialization falls in line with the company's core customer service values, problems have arisen through competition among certain service departments as well as a knowledge shortage of products outside of those departments.

Wells Fargo often promotes cross-selling through referral-based compensation incentives. Many departments budget payments to other departments for referring them business internally. This plan works efficiently in theory, as it encourages employees to constantly assess their customer's financial position and suggest other Wells Fargo products that may be useful. By providing incentive to cross-sell, the company ensures that their customers' first exposure to a new financial product, say insurance, is with Wells Fargo. The reality is that some departments' products can overlap, causing competition for some customers' accounts. This means that a customer may not receive optimal service when mismatched departments offer greater referral incentives. For example, the line between Private Client Services and Executive Personal Banking often blurs when an affluent client is right on the edge of needing the advanced brokerage services that PCS offers. The two branches each cater to wealthy private customers, but the client may prefer some products in the Executive program and some in the PCS department. It so happens that PCS made the decision to list referrals as expenses on their income statement, so they end up receiving more business than Personal Banking from within the bank. Thus, the company runs the risk of devoting resources to clients that likely won't utilize the advanced products. As the deadweight losses of the referral allowances pile up, incentives packages not only hinder the return on investment, but leave customers unsatisfied and confused.

The second problem within the autonomous Wells Fargo departments stems from bankers' incomplete understanding of many of the other financial products the company offers. The cross-selling incentives have lead to advancement in this area, but there is still room to improve. When a commercial customer asks their finacnce-oriented banker about Wells Fargo's commercial property insurance, that banker may not be able to give a clear idea of the benefits of the company's product. Many commercial bankers don't understand the complexities of commercial insurance, and integrating the recent insurance company acquisition with the commercial side of Wells Fargo has been difficult. Rather than force employees to spread their resources to learn about other departments, the company's direct incentive policy encourages employees to take their own time do this in order to increase their pay. In such a system, bankers will not likely neglect current customers to learn about other fields. Rather, they will efficiently divide their time between their own department and improving cross-selling ability. If Wells is to reach its 8 product goal, bankers must possess knowledge of several basic financial products.

## Issue Three – Consolidation in the Banking Sector

The recent mergers of JP Morgan Chase/Bank One and B of A/Fleet Boston have created coast-to-coast financial institutions that can reach far more customers than Wells Fargo's Western-based network. However, these mega-mergers were created at a huge premium, as investors expect to see sizeable returns on the ability to reach a nation-wide customer base. While the addition of new customers naturally leads to lower per capita costs for the companies once the infrastructurea mesh, the costs of integrating different software and cultures may outweigh those benefits. As neither merger has yet closed, the effects cannot be assessed at this time. However, if economies of scope do in fact emerge, Wells Fargo will be lagging as the 4th largest bank by a sizeable amount. CEO Dick Kovacevich stated that he does not wish to devote resources to growing beyond the capacity to keep Wells Fargo a premiere customer service institution. Currently the company strictly focuses on economies of scope through cross-selling, but if the latest wave of mergers creates cost advantages in scale, Wells Fargo could temporarily become caught in a position of competitive disadvantage.

# Conclusions

## Conclusion One

Regarding the potential rise in interest rates, Wells Fargo needs to devote more resources to encouraging cross-selling financial products outside of residential mortgages. Because mortgage origination remains such an integral part of the company's income, switching resources from this area would only weaken Wells Fargo's leading industry position. Thus, the company ought to think about cutting out weaker product areas, such as student loans, or car loans, which have difficulty competing with the government and lower-cost manufacturers. The new resources can then be used to either create/acquire new products or expand bankers' knowledge bases across a wider variety of services. Diversification becomes more important as interest rates rise, so Wells Fargo must plan for this future by beginning to evaluate struggling programs.

## Conclusion Two

For Wells Fargo to remain the industry leader in customer service, they must continue to innovate in efficient cross-selling methods. Virtually all financial institutions attempt to cross-sell, but Wells Fargo does particularly well, given its above-average number of financial products per customer. PAC believes that the current incentive structure truly is the most efficient way to push new products onto existing clients. The current system prevents bankers from devoting too much time to learning about other financial products. Given Wells Fargo's focus on premier customer service, this is an important note because it preserves the knowledge specialization and delivers the highest level of service to customers. If the bank were to constantly force employees to learn about the wide array of products, bankers' knowledge in their area of expertise would have the potential to suffer. With all this in mind however, PAC still recommends that the company take action to promote internal product knowledge. Rather than focus on the receiving end, Wells Fargo should create more opportunities for employees to learn about other areas and network with employees. Departments should be required to offer optional information sessions every few weeks for teams from other areas. By creating more opportunities for bankers to voluntarily learn, the company should be able to boost productivity and more efficiently keep clients within Wells Fargo as they expand their product holdings. The direct financial reimbursement from referrals already drives employees to understand more products, but offering more information sessions complements that desire and will lead the company closer to its 8 product goal.

In regards to the internal competition between departments, PAC suggests that the company regulate the referral fee guidelines for similar departments. The internal competition leads to cannibalizing, as customers may move their money outside of the company if they feel dissatisfied with the services offered by a mismatched department. Thus, the company should regulate referral budgets so that similar departments are only allowed to offer equivalent levels of compensation. The amount can vary within the different areas of financial products, but internal competition needs to be minimized to retain the highest level of customer satisfaction. There needs to be incentive for bankers to cross-sell, but not incentive for departments to merely boost their numbers. The free market idea behind the incentive system creates effective cross-selling without wasting resources like bankers' time. However, a distinction between cross-selling and competitive spirit needs to be established.

## Conclusion Three

While the recent climate of mergers and acquisitions leads many to believe that economies of scale exist for the banking sector, Wells Fargo's core value of service prevents them from aggressively making such an expansionary move. Because these deals have not yet closed, it remains to be seen if analysts' predictions will come true. Wells Fargo has a strong position in the West, and it would not want to jeopardize its values by trying to keep up with the mega-banks. However, the company should not sit idly by, because if economies of scale do exist, Wells Fargo will be stuck facing competitors with lower costs and may have trouble retaining customers. If a larger integrated client network drives down the cost per customer, B of A/Fleet and JP Morgan Chase/Bank One will both be able to cut service fees and compete on the core value of cost. Wells Fargo will likely still have the customer service advantage, but lower checking fees and lower investment costs at other banks could attract current clients away from the company. While PAC does not recommend that Wells Fargo purchase another bank to create a coast-to-coast network, they should begin to devote more resources towards researching potential partners or acquisitions, especially in the Southeast region of the United States. This region is a better choice than the northeast because of its lower competition. Plus, this mortgage-rich company could capitalize on rural real estate more than other services in large cities. But purchasing a bank is not a quick process, and integrating products and culture may take some time. However, the Norwest-Wells Fargo merger of 1998 taught many lessons on integration, and employees feel they could orchestrate a smooth transition. Wells Fargo cannot afford to get caught in a position where they are unprepared to make a necessary expansionary move. If we see that this recent merger wave doesn't affect the cost structure, then Wells can continue its slow eastward expansion without endangering its core value.

Wells Fargo is in a strong financial and strategic position, so advocating sweeping internal changes would be too dangerous. Any drastic changes may upset the balance and detract the company from its cross-selling progress. The subtle changes recommended by PAC help preserve their status as the customer service leader for financial institutions and position the company for future environmental alterations. The banking sector will begin to change this summer as the merger deals close and the Fed likely raises interest rates. Wells Fargo needs to be ready to take action but not make premature moves that might disrupt current operations.