CITIGROUP RETAIL BANKING OPERATIONS IN THE U.S. AND ABROAD: THE BANKING INDUSTRY

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ABSTRACT

Citigroup had been externally focused on acquiring banks and financial services firms from 1997-2005; yet, internally it was experiencing a host of problems that resulted in the firm failing to meet earnings expectations in the fourth quarter of 2005. A key opportunity for improvement was its global consumer business, which is the focus of this paper. In order to bolster earnings for the global consumer group, Citigroup needed to reconsider its domestic and international distribution plan With Smith Barney under its umbrella, Citigroup also needed to determine if and how it should integrate Smith Barney with Citibank branches. Another decision that needed to be made involved Citigroup's product line. With distribution crossing many borders and cultures, Citigroup needed to investigate whether or not it needed to customize its product line by geography. Customers were yet another area Citigroup needed to further explore, specifically, which consumer segments would be most profitable? Finally, the retail banking business relied heavily on traffic into their branches.

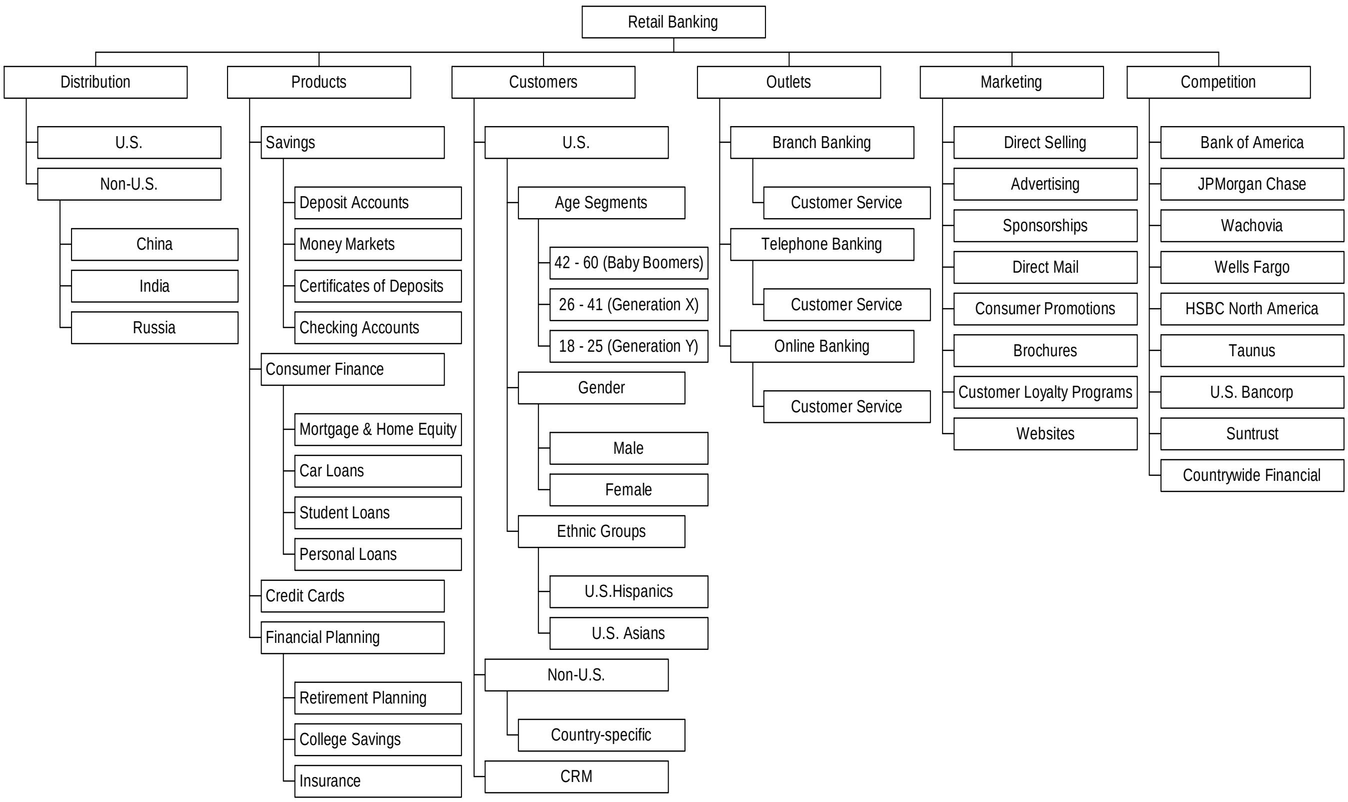
INDUSTRY AND COMPETITIVE MARKET SEGMENT: RETAIL BANKING

Retail banking was conducted by large national banks that had retail branches across many geographic regions of the U.S. (and often abroad) and by state banks that had branches in only one or a few states. National banks offered a full range of products and services to their customers, although some specialized in particular products such as home mortgages. State banks usually offered a more limited array of services and focused on basic banking services such as savings and loans.

Retail banks, whether national or regional, raised funds by collecting deposits from consumers and making loans. Retail banks' primary liabilities were deposits and primary assets were loans. Revenue was earned through disproportionate interest rates between the deposits and loans. Banks made money because the interest they charged on loans was higher than the interest rate they paid on deposits. The interest rate a bank charged on loans depended on the number of customers who wanted to borrow money and the amount of money the bank had available to lend [Tripp, 2005]. The amount available to lend also depended on the reserve requirement the Federal Reserve Board set. Interest rates for specific loans also depended on the risk associated with the loan (i.e., the likelihood of the loan being paid back). Besides interest revenue, banks also generated revenue from the fees they charged their customers (such as ATM fees) and from investments and securities. In its most basic form, retail banks operated by acquiring new customers, maintaining customer accounts, increasing share-of-wallet among existing customers and disposing unprofitable customers (such as loan defaulters).

In order to attract new customers, banks relied heavily on branch distribution and marketing. The rationale for extensive distribution was the more accessible the bank, the more customers it would attract. Marketing was also a key element for driving consumer trial. Marketing was used to raise awareness of the bank and its services and to position the bank as a trustworthy institution in which to safeguard and invest assets. Once new customers opened an account at a particular bank, the bank would maintain the account and provide the customer daily transaction services (for payments and withdrawals) and ease of access to information about the account (such as through telephone and online banking and regular account statements). Maintaining accounts was not enough to drive growth and profits. Banks sought to increase the share-of-wallet from each of their customers. For example, if a customer had a savings account at a bank, the bank would try to persuade that customer to also arrange his mortgage, college savings plan, and/or retirement plan at that bank as well. Again, this was accomplished largely through marketing, especially direct selling to customers by financial representatives on-premise in the branches. Not all customers were profitable. Banks tried to unload customers who were not increasing profits, or worse taking away profits, such as a customer who was not making his mortgage payments. Retail banks offered similar basic deposit and loan services (the latter increasingly referred to as consumer financing), and competed with one another by offering different interest rates. However, banks had limited latitude in the interest rates they could offer/charge and still be profitable, so they tried to differentiate themselves through unique products, exceptional customer service, and a superior branch experience. Most banks operated under similar organizational structures, with the national banks having larger product portfolios, greater geographical reach, more advanced technology and more complicated operations to support the products, geography, and technology. Figure 1 displays the typical banking business process model.

Figure 1
RETAIL BANKING BUSINESS PROCESS MODEL



COMPETITION

The largest U.S. bank, in terms of assets, was Citigroup, followed closely by Bank of America Corporation, and J.P. Morgan Chase & Co, as shown in Figure 2. In 2004, J.P. Morgan Chase acquired Bank One and Bank of America acquired FleetBoston, which put both institutions in the range of $1 trillion in assets (but still behind number one bank Citigroup). Future acquisition deals for these super financial institutions would likely focus on smaller, more strategic acquisition to fill gaps in the international market, which most large banks were trying to gain a foothold in.

Figure 2
TOP 50 BANK HOLDING COMPANIES AS OF 12/31/2005

Rank	Institution Name	Location	Total Assets
1	Citigroup Inc.	New York, NY	$1,494,037,000
2	Bank Of America Corporation	Charlotte, NC	$1,294,312,241
3	J.P. Morgan Chase & Co.	New York, NY	$1,198,942,000
4	Wachovia Corporation	Charlotte, NC	$520,755,000
5	Wells Fargo & Company	San Francisco, CA	$481,741,000
6	HSBC North America Holdings Inc.	Prospect Heights, IL	$395,534,168

7	Taunus Corporation	New York, NY	$364,693,000
8	U.S. Bancorp	Minneapolis, MN	$209,465,000
9	Suntrust Banks, Inc.	Atlanta, GA	$179,712,841
10	Countrywide Financial Corporation	Calabasas, CA	$175,085,370

Source: National Information Center. (2006). "Financial Data and Institutional Characteristics Collected by The Federal Reserve System." [Online]. *http://www.ffiec.gov/ nicpubweb/ nicweb/ Top50Form.aspx*. February 22, 2006.

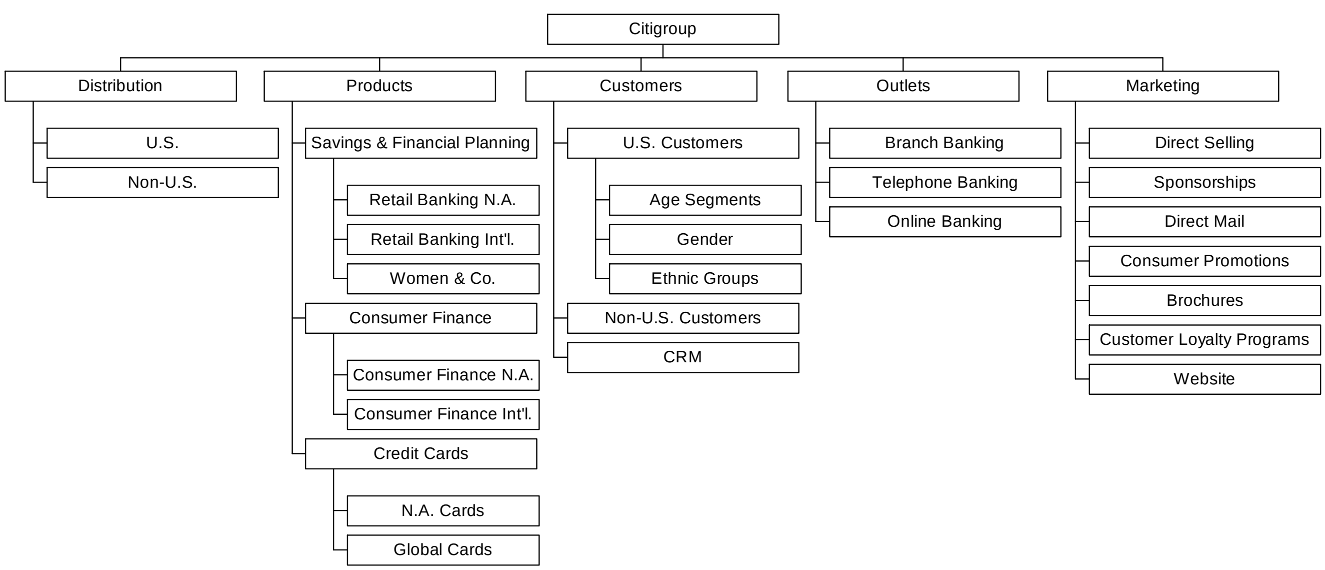
THE COMPANY

Citigroup was the world's largest financial institution. The company organized itself into three major business groups: Global Consumer, Corporate and Investment Banking, and Global Wealth Management. The company also operated two stand-alone businesses: Citigroup Asset Management and Citigroup Alternative Investments. In 2006, the Global Consumer unit was Citigroup's most significant business, accounting for over half of its profits.

Current Situation

CEO Prince seemed to be focused on a strategy of expanded distribution, but with a leaner machine. In 2005, Citigroup sold The Travelers Life and Annuity Company, along with plus most of its international insurance business to Metlife for nearly $12 billion. Also that year, Citigroup sold its commercial truck and trailer leasing and lending business to GE Commercial Finance for $4.6 billion. While J.P. Morgan Chase and Bank of America continued to acquire large domestic competitors (Bank One and FleetBoston, respectively), Citigroup focused on smaller, more strategic acquisitions to fill gaps in its product line as well as in the global market. Citigroup bought the credit card receivables portfolio of Sears, Roebuck and Co. for $32 billion as well as the credit card business of Federated Department Stores and May Department Stores. Other purchases made under Prince's watch included Principal Financial Group's mortgage business, Hibernia's mortgage services, South Korea's KorAm Bank, and First American Bank in the U.S. Figure 3 provides an overview of Citigroup.

Figure 3
CITIGROUP OVERVIEW



Distribution

Citigroup's distribution extended throughout the U.S. and abroad.

Through an aggressive acquisition strategy and an expertise in de novo branch banking, Citibank had built strong distribution with more than 3,000 bank branches and consumer finance offices in the US and Canada. Similar to competitors, Citibank branches were located in prime locations and had good geographic dispersion.

Citigroup had consumer businesses in 53 countries outside the U.S. Citigroup had made great strides in infiltrating foreign markets: In 2004, the company acquired KorAm Bank in Korea (Citigroup's largest investment ever in Asia), partnered with Shanghai Pudong Development Bank in China, and opened its first branch bank in St. Petersburg, Russia (which offered credit cards and consumer lending) [Citigroup Annual Report 2004, 2005]. Citigroup also had a presence in India where it sold credit cards and promoted credit education. Establishing a presence in each of these countries had required in-depth knowledge of the country and positive relationships with their governments. In fact, CEO Chuck Prince had met personally with President Vladimir Putin "to pitch him on a credit card and discuss the bank's ambitious expansion plans in Russia, one of its priority markets" [Chazan, 2005].

Products

The Citigroup Global Consumer businesses comprised a diverse and innovative set of consumer product offerings, including savings and deposits, consumer financing, credit cards, and financial planning in the U.S. and abroad. Products fell into one of several divisions within the Citigroup Global Consumer business unit.

- **Savings and Financial Planning -** Within the Citigroup Global Consumer business unit, savings and financial products were organized into three sub-divisions: Retail Banking North America, Retail Banking International, and Women and Co.
  - <u>Retail Banking North America.</u> Retail Banking North America included branch banking, commercial banking, commercial real estate, commercial financing and leasing, mortgages, student loans, and the Primerica Financial Services distribution channel. Retail Banking North America was operated under the following brand names: Citibanking North America, Commercial Markets/Commercial Real Estate, CitiCapital, CitiMortgage and My Home Equity, The Student Loan Corporation, Primerica Financial Services, Women in Primerica, Primerica Financial Needs Analysis, The Primerica Opportunity, Primerica Financial Solutions, Primerica African American Leadership Council, and Banamex.
  - <u>Retail Banking International.</u> Through its Retail Banking International unit, Citibank offered a financial products and services tailored to meet the needs of local customers in over 50 countries.
  - <u>Women and Co.</u> Women and Company specialized in the unique financial needs of women.
- **Consumer Finance**- Within the Citigroup Global Consumer business unit, consumer finance (lending) products were organized into two sub-divisions: Consumer Finance North America and Consumer Finance International.
  - <u>Consumer Finance North America.</u> The Consumer Finance North America unit offered consumer finance and community-based lending services across North America. The unit had

a customer base of 4.3 million consumers in the United States, Canada, Mexico, and Puerto Rico, operating under the brand names CitiFinancial and Credito Familiar.

- Consumer Finance International. The Consumer Finance International unit offered consumer finance and community-based lending services in 20 countries outside North America, operating under a number of brands around the world.

- **Credit Cards -** Within the Citigroup Global Consumer business unit, credit cards products were organized into two sub-divisions: North America Cards and Global Cards.
  - North America Cards. The North America Cards unit offered credit and charge cards such as Mastercard MasterCard®, VISA®, and private labels. North America Cards boasted over 120 million accounts. Citigroup Global Consumer offered four types of cards in North America:
    - Reward Cards – Cards for earning Thank You Points®, cash back, travel miles, and other rewards.
    - Value Credit Cards – Basic cards.
    - Small Business Credit Cards – Cards that included expert financial advice.
    - College Student Credit Cards – Cards marketed to help students build credit history (did not require a co-signor).
  - Global Cards. The Global Cards unit offered an array of cards to countries outside North America. Global Cards had 20.9 million accounts in 42 countries outside of North America.

Citigroup's Global Consumer business offered competitive interest rates, a wide variety of products and flexible options within each product. Citibank's products covered the four categories of deposits, consumer financing, credit cards, and financial planning. Moreover, customers could choose from a variety of options within each of these product types. For example, it offered several varieties of credit cars, including rewards cards, value credit cards, and college student credit cards. Moreover, Citigroup offered added services such as 24/7 access to accounts, overdraft protection and online bill payments and email banking alerts. Citigroup has faced some challenges in the other keys to success, namely trust, account linkage, and product innovation. Citigroup lost some footing in the area of trust when it became embroiled in both the Worldcom and Enron scandals, which gained international attention. In Japan, Citigroup faced more embarrassment when it was forced in 2004 to shut down its private banking operations there after regulators determined that the company had misled customers regarding the sale of certain structured bonds. And, in the U.S., Citigroup lost a box of computer tapes with account information for 3.9 million of its customers, exposing these customers to the possibility of identity theft [Krim, 2005]. In response, Citigroup sent out letters to all of its U.S. customers warning them to watch their financial accounts for suspicious transactions and offering a 90-day service to alert them if someone tried to establish credit in their name. Still, the company was now associated with security breaches by current as well as potential customers. Account linkage was also a challenge faced by Citigroup, as well as other top banks. While basic savings and checking accounts were linked, customers who had accounts at Citibank and Smith Barney could not transfer across accounts and did not enjoy consolidated account statements. Finally, Citibank struggled with new product innovation. In fact, it had shifted its strategy away from product development and more towards distribution, as evidenced by CEO Chuck Weill publicly stating that Citigroup was a "distribution company now." While Citibank had a full service offering, it still needed to make new product development a priority if it were to keep up with competition.

Customers

Citigroup's Global Consumer business unit focused on two major customer segments: U.S. customers and non-U.S. Customers. Customer relationship management (CRM) was an important tool used for gaining customer insight.
U.S. customers were classified by age segments, gender, and ethnicity.

- <u>Age Segments.</u> Citibank had a history of being all things to all people. It offered products that met the needs of people in all stages of life, from college students to those nearing and in retirement.
  - For its *Baby Boomer* customers, Citibank lagged behind some of its competitors in its retirement savings offer and was on par in its life insurance offer. It had not yet met the emerging needs of Baby Boomers, specifically retirement finance management, elder care insurance, or special education programs about living in retirement.
  - For the *Generation X* customer base, Citibank was weak in its mortgage and retirement savings products, and was competitive in offering college savings plans and one-stop shopping. Citibank had not yet developed a unified, linked account statement or a link between bank accounts and securities accounts (i.e., a link between the Citibank division and the Smith Barney division). There were also opportunities in the industry that Citibank had not taken advantage of, such as personal assistants and supervised play areas in the branches.
  - Citibank was weak in attracting *Generation Y* customers, as it did not offer special services to them, such as student-oriented savings accounts or credit cards.
- <u>Gender.</u> Citibank recognized the potential of focusing on women, and created a special business unit dedicate to their needs called "Women & Company." This unit provided women with tailored education programs, personal attention to help them with their unique challenges (such as survivor financial counseling), and special savings on products and services to meet their needs (e.g., discounts on selected daycares). No other retail bank provided such specialized services to women.
- <u>Ethnic Groups.</u> The company provided Spanish-language brochures and Spanish-speaking financial advisors in branches located in high-concentration Hispanic areas and created marketing messages that focused on benefits to the family, not just the individual. Citibank provided Spanish-speaking telephone representatives but did not have specialized Hispanic customer loyalty programs.

Citibank still needed to create a strategy for bringing Asian Americans into their customer base.

Citigroup was at the forefront of integrating themselves in foreign markets. The company invested heavily in research to understand cultures, behaviors, and financial needs and then developed products to meet unique needs. In addition, it used its research to develop culturally appropriate marketing strategies abroad.

Customer Relationship Management

Citigroup was on the cutting-edge of customer relationship marketing. The company collected information from credit card transactions, so it could tell what customers bought, where they went on vacation and more [Groenfeldt, 2006]. It used this information to cross-sell its products and create more relevant customer rewards programs.

Outlets

Citigroup's consumer banking outlets included branch banking, telephone banking, and online banking.

- **Branch Banking -** Citigroup branches were somewhat outdated, with some branches having a better appearance than others. Compared to some of its competitors (like Bank of America) Citibank branches did not offer a positive, distinctive experience. Customer service representatives were generally knowledgeable, having been trained on Citibank's Citipro® financial check-up, a tool used to measure consumers' financial needs.
- **Telephone Banking -** Citibank's telephone banking was on par with competition in terms of ease of use. Telephone customer service representatives met industry standards in terms of knowledge and professionalism.
- **Online Banking -** whereby individuals made account balance inquiries, transferred funds, paid bills, and managed assets such as stocks online – was launched by Citigroup in 1999. Banks welcomed the idea of online banking because it helped cut expenses. However, adoption by customers had been slow: By 2004, only 40% of Americans claimed to have used online banking [Ipsos, 2004], a technology that had been in existence for five years at that time. A major barrier to entry among consumers was fear of outside companies or hackers gaining access to their personal information. To be successful in online banking, banks had to leverage technology to ensure personal security. Unfortunately, Citibank had lost customer confidence in guaranteeing personal security when it lost customers records in 2005. There was room for improvement in the visual appeal and ease of navigation of its online banking. Online customer service was adequate in terms of knowledge and being easy to reach.

Marketing

Citigroup leveraged a variety of marketing tools to inform customers about their products and services and persuaded them to try them. These tools included direct selling, advertising, sponsorships, direct mail, consumer promotions, brochures, customer loyalty programs, and their Website.

- **Direct Selling -** Citigroup supported its direct selling by arming each of its financial advisors with the Citipro® financial check-up tool, which allowed them to better understand their customers' needs.
- **Advertising -** Citigroup's Global Consumer Group's marketing focused largely on its "Live richly" advertising campaign. Launched in 2001, the campaign won numerous awards. The campaign's objective was to communicate that Citi is "an advocate for a Healthy Approach to Money." The campaign positions Citi as an "active partner in achieving perspective, balance, and peace of mind in finances and in life for its customers." The "Live richly campaign used lively, color imagery and engaged the consumer because it focused on the consumer benefits, but still was not up to par with the creativeness of competitors' advertising. The "Live richly" campaign appeared in television commercials, print ads, phone kiosks, billboards, bus shelters, subway stations, and construction bridges. The outdoor component of the campaign was shown in six cities in the U.S.: New York City, Chicago, San Francisco, Los Angeles, Miami, and Washington D.C.
- **Sponsorships -** With sponsorships of variety of well-known charitable organizations, such as the American Red Cross and Habitat for Humanity, Citibank is on par with its competition.
- **Direct Mail -** Citigroup made extensive use of direct mail, which educated customers about its various products and made it easy for them to sign-up for cards simply by dialing a toll-free number. Direct mail pieces fit Citibank's brand image.
- **Consumer Promotions -** Citigroup's consumer promotions were on level with the competition.

- **Brochures -** Citigroup brochures carried out the "Live richly" campaign by using the same imagery and focusing on how Citibank products could help customers live more fulfilling lives by acquiring and renovating their homes, taking vacations and the like. The quality of their brochures and their distribution were average.
- **Customer Loyalty Programs -** Citigroup offered an easy-to-understand rewards program called the "Thank You Network®" which enabled customers to earn points for using many of Citibanks's banking services. The program was easier to understand than most competitive programs, although the rewards offered were mediocre.
- **Website -** Citibank's Website was weak. The Website mixed corporate information with consumer information, and the links were scattered making it difficult to navigate and, therefore, difficult to find product information and other critical information. Moreover, the website did not feature the imagery or messaging of the "Live richly" campaign used in the company's advertising and brochures. The Website could not be used by customers to educate themselves about financial instruments.

Management Strategy

Chuck Prince had been named CEO of Citigroup in October 2003. Filling former CEO Sandy Weill's shoes was not an easy job. Over the last two decades, Weill had built Citigroup from the ground up into the largest bank in the U.S. and a global financial services powerhouse. Before being named CEO, Prince had served as general counsel under Weill overseeing regulatory matters and not involving much with the strategy or operation of the company. Now, Prince had to develop a vision for Citigroup and implement a strategy that would bolster its global consumer business performance and ensure Citigroup's dominant position into the future. Citigroup's main competitive advantages were its name and scale, and Prince was counting on these strengths to successfully implement his three-prong strategy for Citigroup [Der Hovanesian, 2006].

<u>First</u>, Prince was planning to expand Citigroup's consumer business from 53 countries to all 100 countries where Citigroup operated. However, Prince faced obstacles in his plan for global distribution. The Citigroup name was not as well recognized abroad as in the U.S and there was already mistrust in certain markets where regulations were not followed (and thus scandal ensued). Moreover, Citigroup's economies of scale might not have fit neatly into certain foreign markets where customization of Citigroup's products might be needed. <u>Second</u>, Prince was planning on upgrading CitiFinancial, the consumer finance unit and targeting the newly affluent consumer group (i.e., those consumers with $100,000+ in assets). The Citigroup name might not have been as leverageable in attaining this goal either. Citigroup had traditionally followed a strategy of all things to all people, and now it was seeking to specialize in servicing a higher-end customer. It was likely that consumers did not associate Citigroup with higher-end financial services. <u>Third</u>, Prince sought to combine Smith Barney brokers and Citibank retail branches. Smith Barney was the global private wealth management unit of Citigroup. It was a leading provider of comprehensive financial planning and advisory services to high net worth investors, institutions, corporations, and private businesses, governments, and foundations. With approximately 12,100 financial consultants in some 500 offices, Smith Barney offered a full suite of investment services, including asset allocation, private investments and lending services, hedge funds, cash and portfolio management, as well as retirement, education, and estate planning. Smith Barney had more than 7.7 million client accounts, representing $1,015 billion in client assets. While integrating Smith Barney into Citibank retail branches would expand the Citibank product offering and increase Smith Barney distribution, the combination of the Citibank brand name and the Smith Barney brand might send mixed messages to consumers. In order to make his plan a

success, Prince would need to make hard decisions about his global distribution plan, his product lines, who his customer base was, and how he would reach them.

LOOKING TOWARDS THE FUTURE

CEO Chuck Prince had to form a strategy that would improve Citigroup's Global Consumer unit, which the company depended heavily on for revenue generation. One alternative was to aggressively expand Citibank and CitiFinance branch locations in the U.S., which would attract new customers to the Citibank and CitiFinance franchises, and thus increase revenue for the Citigroup Consumer Business unit. Another alternative was to expand existing Citibank and CitiFinance locations in the U.S., and begin distributing Smith Barney products through Citibank branches. These were two alternatives that new Citigroup CEO Chuck Prince would have to consider in order to grow Citigroup and maintain its leading position versus Bank of America and J.P. Morgan Chase & Company. Both alternatives would grow Citigroup, with the second alternative being the riskier – yet potentially more rewarding – of the two. Prince would have to consider these two alternatives, and consider other opportunities that Citigroup might pursue.

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