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Putting the Customer in the Driver's Seat

Introduction

As you may know, I'm a relative newcomer to the banking industry. But you don't need to be a banking veteran to recognize that the industry is undergoing a transition. In fact, the perspective that I have from prior lives may be helpful when assessing the various strategies that banks have for managing this transition. I'll say it now, and again and again, success depends on putting the customer in the driver's seat.

Slide- Factors Driving Industry Change

Today, companies in all industries compete in a constantly changing environment, driven by shifting customer demands, advances in the application of technology and continuing globalization. These three factors interact with each other, producing a powerful impetus for change. Autos, airlines and telecommunications are but a few examples of industries that have been pushed to restructure the way they do things. I believe that the experiences of these industries provide some hint as to what's in store for banking. It isn't all pretty, but it isn't all bad, especially if you're the customer.

Since I spent a number of years in the auto industry, and I remain an auto enthusiast to this day, I find it provides a most interesting comparison. Let's review how these factors impacted the restructuring of the auto industry. They proved that the customer is in the driver's seat.

Slide- Rickety Japanese Car vs. American Road Cruiser

Some of us can remember the Japanese cars that came to the U.S. in the 50s and 60s- many of them rusted before they left the dealers' lots. One company exported a "people's car" to South America; they picked the name out of their Latin dictionary and called it "publica", only to discover the word meant "public restroom" in Peru. There were other stories- when another company went to Europe, they decided to let a German advertising company select the name for the car. The Germans asked how soon they needed the name, and with just-in-time precision the Japanese replied "right now", to which the Germans exclaimed "Dat Soon"?

But, despite early miss-steps, the Japanese focused on what the customers wanted, and worked on providing just that. They concentrated on the U.S. market, using the Willy Sutton bank robbery theory, because the U.S. was where the car buyers were. Incidentally, after he was captured, Willy was asked where

the banks' money had gone. He replied that he'd spent 90% of it on wine, women and song, and wasted the other 10%.

Slide- Sleek Japanese Car vs. American Road Cruiser

In the 70s and 80s, Detroit lost touch with consumers, and continued to believe that Americans would always demand the heavy iron road cruisers loved by the post-war generation. The Japanese focused on the next generation of U.S. auto buyers and learned that this increasingly affluent crowd wanted customized high tech features, not Detroit's mass-assembled products. They put their minds and technology to work to deliver it. Unburdened by Detroit's traditional concept of a base car with add on equipment, the Japanese built cars loaded from the ground up, with features customers wanted. Japan side-stepped the expensive distribution problem by enticing American car dealers to add a second line. Your local Oldsmobile dealer quickly became Oldsmobile/Honda, and guess which product the customers chose. As one of my former colleagues once said, "the real test comes when the dogs won't eat the dog food."

As far as globality goes, since there were no significant U.S. import barriers, the penetration of this market was easy. And when oil prices rose, the Japanese hit pay dirt, as consumers further shifted their preference toward the small, fuel efficient cars that the Japanese were already producing to fit the roads and gasoline prices in Japan.

Slide- Factors Driving Industry Change

So the circle was completed: changing customer demands were satisfied using technology as an enabler, and the concept was applied without geographic constraint to reach the broadest market. It comes back to the most important element: the Japanese auto companies succeeded because they put the American consumer in the driver's seat.

Slide- Japanese Godzilla vs. American Dinosaurs

Was that the end of the story? Were the big three auto makers just gigantic chrome-plated dinosaurs? Would Godzilla succeed where King Kong failed? That sounds similar to what's being asked today; about banks- Will Microsoft, Motorola, Intuit and/or Intel replace dinosaur banks and their bricks and mortar? Of course the story doesn't end there.

Slide- Sleek Japanese Car vs. Sleek American Car

The next chapter starts with the customers again, and how the big three worked hard to get back in touch with them. Ford made quality job #1, GM focused on dealer and customer service, and Chrysler on redesign. They all rethought the product development and production processes to provide the features customers wanted, at an improved price for value ratio.

Technology was an important enabler, but not the sole answer; GM first went down the robot road, only to discover that while robots were useful, they were far from the only answer. The real breakthrough came when, instead of having just one person in the factory responsible for quality, it became the responsibility of everyone.

Globality was an important key for both Ford and GM in making the turnaround - the strength of their European business carried them through the difficult times in the U.S. (Remember that Europe put tight restrictions on Japanese imports.) And when Europe slowed, Latin America and Asia surged ahead. Chrysler almost didn't make it because of lack of geographic diversification, but their smaller size and greater dependence on outside resources gave them greater flexibility, so they were able to make the quickest turnaround in costs. And they exploited product niches. They discovered the demand for mini-vans and sport utility vehicles, and here's those words again, they put the customer in the driver's seat.

Slide- Factors Driving Industry Change

Again, the circle always comes back to the customer. The U.S. manufacturers used technology to develop a common platform for cars around the world, which still permitted local variations to respond to customer demands, and they transferred successful innovations globally to improve customer satisfaction. The success of Japanese exports drove the Yen up so that the price to value equation, a key customer demand, flipped back in favor of the U.S. The absence of a dedicated Japanese dealership network meant that the dual dealers switched emphasis back toward the home-made products as quickly as they switched it away.

The lessons at the end of the day are that the customer is always able to ferret out value, and that satisfying customer demands is the first and most critical step to creating shareholder value. And that's why you have to put the customer in the driver's seat.

Slide- Old Style Bank Branch

How does all of this apply to consumer banking? We all know the history. A couple of decades ago, the deregulation of interest rates, triggered by customer dissatisfaction, forced dramatic change in the industry. Banks responded by offering customers what they wanted, deposit products with market rates such as money market accounts. At the same time inflation was driving up the costs of bricks and mortar, and people and paper. Interest rates were pushed up higher to cool things off, and banks' profit margins were really squeezed. The cost pressures have continued, forcing banks to try to take advantage of new technologies, and to try to wean their customers away from expensive tellers. We can all remember the backlashes, as banks' needs sometimes moved ahead of some customers' willingness to change. In the meantime, consumer groups

are protesting branch closings and fee increases, while new non-regulated competitors are entering the market, targeting on profitable niches. (PAUSE) Needless to say, banks are struggling with this transition.

Slide-Delivery Channel Costs

Transaction costs range from \$1.07 for teller service to 14 cents for a preauthorized debit. It costs 27 cents to service a customer at the ATM and 35 cents over the telephone. It is clear why some banks now charge customers for using a teller, or alternatively give them free ATM or phone access- because by moving customers out of the teller line, banks can reduce transaction costs by two thirds. The challenge is to make the most cost efficient delivery channels the most satisfying ones for the customer. Some of the reasons for this struggle are critical to shareholders.

Slide-Retail Delivery Channels

Despite the economics, in 1993 branches continued to absorb 55% of bank transactions- and the bulk of the complaints! It has taken years to develop the acceptance of ATMs, and while many customers think ATMs are friendlier than the tellers, they still only represented 36% of bank transactions. The telephone handled another 9% of transactions. And PC banking didn't even make the chart, but it will soon.

Slide-Delivery Channel Usage

Change has been slow, largely because consumers are habit-bound and cautious when it comes to financial matters. The American Banker conducted a consumer survey several years ago to test delivery channel preferences. Sixty percent of the group surveyed indicated that they had an ATM card, but only 31% used the card four or more times per month. Customers have been slow to take full advantage of the card. For example, 40% of the time the card has been used for cash withdrawals, but less than 10% for making deposits. Telephone banking attracted much attention. Fifty-nine percent indicated interest in banking by phone, but only 30% did so. Nineteen percent of those surveyed expressed interest in a debit card. But only eleven percent indicated interest in PC banking, despite the fact that 18% of respondents already owned a PC with a modem.

When customers aren't truly satisfied with the products you believe give the best value for price, you have a situation in transition.

Slide- How do you Measure Performance?

Certainly its important to understand the cost implications of these various distribution channels and the patterns of customer behavior. Investors want to know whether or not a bank is positioned to meet customer needs in a cost effective way. But the customer doesn't want to know about any of this. The customer wants a consistent, convenient, high quality banking experience, regardless of how he or she prefers to bank.

As an example, compare these two approaches to customer satisfaction. The standard today is to worry about whether or not the call is picked up on the first ring, not how long it takes to pick up. It's about whether customer service reps handle the calls in a courteous way, not how many calls are handled per hour. It's about resolving issues immediately, eliminating the need to count the number of days it takes to resolve an issue. What's most important is the customer's satisfaction with their experience, and surveying this continuously for feedback.

Give Auto Example- Iacoca

Slide- New Style Bank Branch

What does this all tell us? It is clear that at the same time traditional customers are reluctant to change, there's a new set of customer whose demands for convenience will push us toward new applications of technology. This will be driven by the preferences of younger consumers as they build their net worth. The crowd that boots up Windows every morning as they sit down to work, wants to bank by clicking on icons from their drivers seat in front of a PC. On the road or at home, busy moms and dads want to bank the way they do everything else- telephonically.

The shape of retail banking will change dramatically, and alternatives to branch distribution will become more important. It is unlikely that any one distribution alternative will be preferred by all customers, all of the time. Therefore there is not one "right" distribution strategy for all banks. Today's and tomorrow's consumers want products integrated for delivery through various access devices, so that they can manage all of their wealth anytime, anywhere, any way. This is what our strategy, called Citibanking, is designed to do.

Slide-Three Core Beliefs

As you have heard many times, from John Reed and Pei Chia, when Citibank launched the worldwide consumer business 20 years ago, it was formulated around three core beliefs. Our strategy remains based on the same three core beliefs. First, the importance of satisfying the customer. Second, the power of technology to be applied to do that. And finally, the potential of our global reach.

Slide-Evolution of Citibanking

Alternatives to branch banking have been critical to our strategy since we employed the first ATMs in 1977. We have evolved the ATM into a proprietary full service banking machine which we call a customer activated terminal or "CAT". We continue to add features and services, like the ability to buy and sell mutual funds and U.S. equities. Today, our customers in the U.S. activate our CATs more than 15 MM times per month.

Our PC-based home banking product has been on the market for 11 years, and we continue to add features and functionality to it.

In 1990, in San Antonio, Texas, we established a "Branch in the Sky", open 24 hours a day, 7 days a week, to support multi-language Citiphone banking in the U.S. We have replicated this capability in all of our major consumer markets around the world.

The model branch concept, originated in Chile, embodies a distinctive Citibank identity- the blue wave- and integrated technology. To date, nearly 450 of our 1200 branches around the world have been upgraded based on this concept. Come see one on Park Avenue at 53rd Street.

We continue to develop new alternatives. This year we are testing Customer Activated Service Terminals, which help a customer assess risk tolerance and develop long-term investment objectives. We do this to provide a non-threatening environment to lay the groundwork for a productive private meeting with an investment counselor.

Slide- Integrated Products and Access

Customer research and experience has led to a comprehensive integrated product offering- the Citibank Relationship Account- that is accessible through range of delivery channels, including the branch, the phone, or by PC.

Our customers are able use the access vehicle they prefer to manage their banking relationship. For example, if you are vacationing in Paris, not only can you can use the Customer Activated Terminal at our Champs-Elysee branch to obtain Francs from your home account, but you can also transfer money to your son or daughter to buy an airplane ticket to come home for the holidays.

Slide- Integrated Products and Access

Each aspect of the customer's relationship can be managed through all access channels. Regardless of the channel, the customer will recognize the same quality of service, the same sequence of information, and the same terminology, and equal capabilities.

Slide- Integrated Products and Access

With Citibanking, our customers can conduct all of their banking business Anytime, Anywhere, and Any Way.

In addition, product and access integration allows us to take advantage of performance improvement opportunities- to increase our service to customers while at the same time reducing costs.

Slide- Global Consistency

We offer Citibanking in 41 countries, with more to come in the future. We are the only bank that is providing global retail banking.

Citibank customers traveling around the world experience the same banking and service they're accustomed to in their home country. Through our International Citicard network, they can withdraw local currency from their home account via our CATs, and transact other business as if they were still at home. Citibank has been building toward this global integration for over 20 years. And success transfer has allowed us to leverage our positive customer experiences created around our global network.

Slide- Brand

We are building on the Citibank name, the most widely recognized name in consumer banking. The objective is to deliver a unique customer experience, one that is readily recognized and valued. The Citibank brand attributes are: customer driven, innovative, global and trusted. We will declare success when Citibank is the first name that comes to mind when looking to fulfill a financial need.

Slide- Opportunity

What's our opportunity? Our corporate bank operates in 95 countries today, and is continuing to expand its presence, as more countries open up to foreign investment. We will likely pass 100 countries sometime next year, with each additional presence adding value to our customers around the entire network. That's how our corporate business grows.

Slide- Opportunity

Our consumer banking business is in 41 of those 95 countries. We already have a presence in over 50 more countries into which we can expand our consumer business. Further, as we grow in each country, we expand our product set, adding cards and private banking to our Citibanking presence, and building the strength of our brand. Our market shares start small generally, but grow. Most importantly, our target market is growing, as wealth spreads and middle class formation around the world continues. We project 20% growth in the middle class around the world over the next 5 years, or 137 mm new members worldwide.

Introduction to Video:

But don't just take it from an old auto guy. Let's hear from the veterans- Here's one view of the outlook for the consumer banking business in light of changing delivery technologies:

Pause to allow the audience to read this statement:

“The existence of new delivery technologies strongly suggests that we should either reconfigure and reinvigorate our own efforts or get out of the business - our current posture is not economically viable over the long run.”

Don't worry. Citicorp is not contemplating exiting the consumer business. This statement was actually made by John 20 years ago, in a memo written while he was supposedly on vacation. It became famous around Citicorp as “the memo from the beach”. We did indeed reconfigure and reinvigorate our consumer business, and that has brought it to a profitability level approaching \$2 billion this year. Let's hear what John has today.

Play video- approximately 10 minutes.

Slide - The Citi Never Sleeps

As in the case of the auto industry, banks are faced with a continuously changing environment. Shifting customer demands, new applications of technology and continuing globalization are driving banks to restructure the way they do business.

Just as there was not one solution for the problems of the American auto industry, there is not one solution for retail banking. Our strategy recognizes the factors driving industry change. It is built on satisfying the customer, applying technology in new ways to do so, and leveraging our global opportunity. Most importantly, Citibanking puts the customer in the driver's seat, so that they can bank anytime, anywhere and any way they choose to do so.