Wells Fargo Case

I. Introduction:

The emergence of electronic transaction processing - and particularly the Internet - has created both threats and opportunities for the banking industry. This study examines how the emergence of e-banking has affected the competitive dynamics of the banking industry, especially as it pertained to Wells Fargo during the period from 1996 to 2000. Included are estimates of market share, revenues, transaction costs and break-even, and discussion of market opportunities, threats, strengths and weakness, along with an analysis employing the theoretical framework of Porter's 5-Forces Competitive Model. Also addressed are methods by which Wells Fargo could increase market share, lower operating costs and establish a competitive advantage that could be sustained over time.

II. Market Potential for e-banking at Wells Fargo:

*1. Market Potential & Sales Forecast **	*1996*	*1997*	*1998*	*1999*	*2000*
a. Total e-banking customers	2500000	3500000	4900000	6860000	9604000
b. Wells Fargo Market Share**	300000	420000	588000	823200	1152480
Internet	110000	210000	352800	576240	921984
On-line	95000	105000	117600	123480	115248
Electronic	95000	105000	117600	123480	115248
c. Total Revenues ($MM)	$6,721	$9,409	$13,173	$18,442	$25,819
d. Revenues from e-banking***	$403	$968	$2,323	$5,575	$13,379
e. Annual e-banking expenses****	$50	$55	$62	$65	$61
f. Net Revenues from e-banking	$353	$913	$2,261	$5,510	$13,319
g. Net revenues per e-banking customer ($1)	$1,178	$2,173	$3,845	$6,693	$11,556
h. Breakeven number of e-banking transactions:					
Internet @ .01/transaction (in millions)	1,100	2,100	3,528	5,762	9,220
On-line @ .54	51,300	56,700	63,504	66,679	62,234
Electronic @ .015	1,425	1,575	1,764	1,852	1,729
Assumptions:					
1. Annual growth rate - 40%					
2. Wells Fargo market share of e-banking business: 12% (+- 25%)					
3. Annual cost to Wells Fargo of Internet service: $40M					
***** Includes attrition of approx 5% (about 1/2 that of brick and mortar channels)***					
****** @ initial contribution margin of 6%, increasing 140% annually***					
******* Annual cost of Internet service = $40M; other service expenses vary by year***					

The 5-year market potential depicted in the table above reflects anticipated growth rates, based on the following data (Stanford 1997):

1. By June 1994, around 100,000 US households were using electronic banking. But the adoption of electronic banking increased rapidly beginning in 1995, growing to 400,000 US households at the end of 1995 and to 2,500,000 US households at the end of 1996.
2. By August 1997, Wells had about a 12% market share, with approximately 370,000 on-line customers, 190,000 of whom were on the Internet. Looking forward, Wells hoped to have from 1.2-2.0 million Internet customers within the next five years.
3. Wells estimated that the total annual cost of the Internet service over this period would be approximately $40 million.
4. Electronic banking also offered the potential to reduce customer attrition by allowing customers to continue accessing the bank's services even after they move.
5. In 1996, Wells had net income of $1.1 billion, with revenues of 6.7 billion - $4.5 billion from net interest income and $2.2 billion from non interest income (10k report 1996).

III. S.W.O.T.

A. Strengths

Of all online financial services providers, banks have an unparalleled information base. In addition, banks have an intangible asset that would be very hard for competitors to break down, one that they have been building since the early 1800's - customer relationships. Many banks were using Quicken and Money to offer their customers on-line banking services, including the ability to make on-line bill payments. Wells Fargo's overall objective in 1996 was to have the most functionality available to the most customers possible. Toward that goal, the bank had several innovations in progress in 1997, including Mondex (an electronic-cash card), Online Banking and WebTV, Business Centers, and Virtual Stores (electronic commerce solutions to small and medium sized businesses that wished to sell goods over the Internet)

Too, banks can provide additional industrial and financial information, market research reports, financial planning software, and other value-added services. In addition, banks can use collaborative filtering to offer recommendations based on past transaction profile or customer interaction and tailor the services to the customers (JECR 2006).

B. **Weaknesses**

Many banks experienced start-up problems with home banking (Stamoulis, D., P. Kanellis, and D. Martakos, 2002). The Chemical Bank in the United States, for example, introduced Pronto Home Banking and Pronto Business Banker for small businesses in the early 1980s. Pronto failed to attract enough customers to break even and was abandoned in 1989 along with Citicorp's Direct Access and Chase Manhattan's Spectrum home banking. The fundamental questions facing most executives during the late 90's were whether Internet banking would face the same situation and whether customers would adopt this service. Their concerns are understandable considering that the Security First Network Bank, recognized as the first virtual bank in the world, and other Internet banks were still struggling for profits at that time.

C. **Opportunities**

The emergence of e-commerce provided many new business opportunities for both existing and start-up banks, especially since on-line capabilities created efficiency, convenience and customization for the banks' clients. Some of the new online services banks could offer included bill presentment and payment, credit card transactions, electronic cash, brokerage services and insurance

products, each of which would garner enormous transaction fees, commissions and service charges at very little expense to the institutions.

D. Threats

Wells faced competitive pressures on a number of fronts. Most banks were moving aggressively to offer Internet based transactions. In acquiring customer deposits, Wells competed with brokerages like Schwab and Fidelity (Stanford 1997). Schwab and other brokerages had enjoyed great success at acquiring consumer investments, and were offering a number of services that had traditionally been offered by banks. For example, Schwab offered check writing and debit card services through their SchwabOne accounts, allowing customers to conduct transactions against their mutual fund deposits. Schwab also sold life insurance and planned to offer mortgages as well.

Virtually anybody could become a competitor in the industry. These potential competitors included those organizations traditionally not involved in the banking industry, such as computer and technology firms and cable and other media companies that had a technological edge and the proper vision of electronic money to lead the future of commerce. It was also possible that Wells could face competition from technology firms, such as Intuit and Microsoft (ibid).

IV. E-Banking and Porter's 5-Force Competitive Model

In his Competitive Model Porter (1979) argued that the nature and degree of competition in an industry hinged on five forces: the threat of new entrants, the bargaining power of buyers, the bargaining power of suppliers, the threat of substitute products and the jockeying among current contestants. He said the

collective strength of these force determines the ultimate profit potential of an industry. This section will use Porter's model to examine the effects of the rise of e-commerce on the retail banking industry.

A. **Impact of e-Banking on Threat of Entry**

Threat of new entrants is high: unfavorable - the rapid growth of online software that can be deployed by anyone at low cost may bring new entrants to the market and Internet banking enables the emergence of new competition, such as brokerage houses and insurance companies.

B. **Impact of e-Banking on Bargaining Power of Buyers**

Indirectly, e-banking services increase the bargaining power of buyers, shifting the balance of power from the bank to the individual customer (Brennand 1999). Even the largest and most favored customers have only narrow bargaining power with regard to interest rates. Buyer power is low with regard to rates and fairly good regarding fees and payment terms. As for product selection power, instead of accepting off-the-self financial products or services, customers can choose their personalized financial services in an e-banking context. However, e-banking offers alternative approaches by which banks can provide individual offerings and services to attract customer interests, increase customer loyalty, and repeat transaction (Wind 2001). Internet banking also provides banks with a more economical alternative distribution channel. As more new comers are expected to enter the industry, banking customers are facing more alternatives that increase their bargaining power. This is evidenced by the fact that most Internet banking services are now free of charge.

C. **Impact of e-Banking on Bargaining Power of Suppliers**

Supplier power is moderately high with regard to rates; but low with regard to customer retention: slightly favorable. Banks have previously acted as suppliers. However, in this new Internet banking world, banks are no longer gatekeepers but gateways to financial products. In the new gateway model, the bank provides access to an entire spectrum of products and delivery channels. Some of the products may not originate from the bank but from a third party provider, such as Intuit, Microsoft or AOL Time Warner. As it is believed that eventually there will only be a few gateways (suppliers) such as AOL Time Warner and Microsoft, the bargaining power of suppliers was strong in the mid- to late 90's.

D. **Impact of e-Banking on Threat of New Competitors**

Competition is very high and unfavorable, and customers can easily switch to a competitor. The Internet fundamentally lowers the barriers to entry that allow more new competitors. It gives people from other industry segments opportunities to succeed in businesses where they had little or no presence before. The Internet enables extremely low switching costs to substitute providers. The operations costs for Internet banking are lower than those of traditional distribution channels.

E. **Impact of e-Banking on Rivalry**

Rivalry is high: unfavorable - products are not so differentiated that new features and services will remain novel for long. Electronic commerce has enabled small banks to compete on equal ground with the large-scale multinational financial

giants, because the traditional high-cost, brick-and-mortar branch is not mandatory. The physical size of the banks becomes less relevant. The Internet's universal standard eliminates costs involved in customers changing to a new provider. The Internet enables both existing players and new entrants to play by a new set of competitive rules that leads to an extremely volatile competition.

V. Long-Term Marketing Strategy

Wells Fargo's long range strategy during the late-90's growth phase of e-banking need to be based on two primary strategies:

A. Delivering differentiated services.

Bundling and cross-selling are possible strategies for differentiation (Altinkermer 2001). Another strategy is service customization, which offers tailor-made individual offerings and services to the clients, offering customers more control in the transaction process and targets to solve the particular needs.

Banks can use data mining techniques to analyze the customers' patterns of doing business and preferences, so as to influence customer decision-making by framing the choice options and making it easier, more productive, more engaging, and cheaper for customers to deal with them than with competing banks. Here, success in this endeavor would enhance the differentiation of financial services, which would in turn strengthen customer satisfaction and loyalty, increase repeated purchases, and attract new customers (Schaupp and Belanger 2005).

B. Proper management of customer relationships

Since demographic change is an important issue in evolution of e-banking, to exploit the change and increase market share, banks must seek to attract and

capture such potential clients as early as possible by supplying a low switch cost technologically and innovative and sophisticated products and services such as global e-banking and mobile transactions over the Internet (Nelson 1997).

VI. Conclusion

E-commerce drastically affected the competitive landscape of the banking industry in several ways. First, it changed the industry structure and, in so doing, altered the conventions of competition. Second, it created competitive advantages for banks by giving them new ways to outperform their rivals. And finally, it gave rise to the creation of new businesses that are beyond the traditional banking domain.

This paper has provided a summary of Wells Fargo bank attempts to capture and retain online customers during the period from 1996 to 2000, particularly with regard to opportunities for growth and competitive strategies, and including an assessment of likely market share and profitability.

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