MEMORANDUM TO: MESSRS. LONG, SVP
KOVACEVICH, VP
PHILLIPS, SVP
TOZER, SVP

Note: Please distribute to your Business Managers and key marketing/operating officers.

Re: Consumer Business

I. As you may know, I make a pretty good effort to use my vacation to do nothing. That turns out to be hard. So from time to time I jot down notes and thoughts relating to different things that are going on. The following comments are not particularly well organized - and are certainly not exhaustive - but do reflect some of my concerns about our common effort in the Consumer Services Group. They are passed along in an attempt to communicate and to open up lines of communication.

II. It should be pretty clear that we are creating something new. The consumer banking business has been - at best - a sideline effort as related to corporate banking in Citicorp. In addition, the business has suffered the severe economic burdens of inflation which have been working on a distribution system designed for the "banking business" when in fact there is no such thing. As a retail system - the branches are overdesigned - as a corporate presence they are unnecessary. The card business suffers from an inflation vulnerable paper processing base - the domestic businesses from their birth as "congenerics" and the overseas consumer effort - even more than in New York - has taken a back seat to the explosive growth of the IBG.

Our current efforts reflect the conviction that in the years ahead the consumer business will be fundamental to Citicorp - that it is not a sideline business but a core business - and that <u>we</u> must bring it into an operative reality.

This conviction is the result of an internal assessment of Citicorp and where we are going but more importantly speaks of the external world and the view that the consumer sector is immensely large, growing in importance and currently poorly served by financial organizations. In addition, it is clear, that some relevant new delivery technologies are available to the business and will have an important bearing on both the economic dynamics and the institutional and legal/regulatory framework within which we work. The existence of these technologies strongly suggest 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.

When I say that what we are building is new - I am not referring to these technologies nor to new delivery systems. Rather, I refer to a fundamentally new business starting with a dedication to the consumer and to the proposition that we can offer a set of services that will substantially satisfy a family's financial needs under terms and conditions that will earn the shareholders an adequate profit while creating a healthy, positive and straightforward relationship with the customer. Currently problems characterize each phrase in this statement: (1) it is our perception that consumer needs are only inadequately satisfied; (2) the business has lost money and is consistently under our hurdle rates; and (3) the relationship with customers has been characterized by too many instances of poor service, poor products, bad pricing and other negatives.

III. It should be clear that we must start with the consumer, with the family unit and with its needs for financial services. Our objective cannot be to be in the loan business or the deposit business. The task is not to run branches nor to issue cards. These are but a means to an end - the business is an effort on our part to manage resources so as to satisfy consumer needs. Our products and services will change as these needs evolve. The rationale for a given distribution system will be derived from the need to provide services and facilities for their delivery.

IV. It is both possible and desirable to describe the results of our efforts. I do so by categorizing them in three ways: the occupation of space, profits and the character of the business organization itself. That is -

A) Occupation of Space - along three dimensions:

1. our share of the relevant market;

2. within that share - our tier position or the share of the total actual uses of financial services for a family unit that is a customer; and

3. our psychological position - i.e., how "well" do we satisfy, to wit, how healthy is the relationship.

B) Profits - along two dimensions:

1. absolute contribution or PCE; and

2. quality of RORA.

C) Character of the Organization - along three dimensions:

1. to what extent does the work organization provide a healthy environment for each of us;

2. to what extent does the organization learn and regenerate itself developing skills and people to cope with new and different problems; and

3. to what extent is the organization a healthy contributing part of Citicorp.

V. The "how" by which we achieve results is very much in an early developmental stage - we clearly have a lot to learn and much that seems obvious today may turn out not to be. A set of priorities has been stated: namely, control, profitability and then growth and each Division is working on an identified set of business tasks and objectives. Our 1976/77 plan describes the Group's direction.* Hopefully, as of this moment, we are organized to get to work! We rejected a functional organization so as to build around the concept of the Business Manager. In doing so we recognized that we may have sacrificed some time but were pursuaded that the "business manager" was a better long term concept because: (1) it would build more good people; (2) it implied that we would break the CSG into manageable pieces (twenty-four business managers); (3) it forces operating level business responsibility down into the organization; and (4) it insures a balanced "full business view". At the same time, it sacrifices some of the professional thrust of operations and marketing and, at least, during 1976/77 burdens the CSG with a large number of key slots filled with individuals new to the business and new to their job. In short, we will experience a learning period. We must also develop a reasonable management mechanism to talk to each other.

VI. Leadership is obviously crucial to our effort. The CSG is a massive organization including some eighteen thousand of us in eleven countries. The key day to day management slot is that of the Business Manger. The tone of the organization and the extent to which we "pull together" is very much dependent on the efforts at that level. It is important to recognize that the "people" dimension of our job is a line responsibility. A staff function - personnel - is not going to maintain the fabric of the organization. Insuring that people are listened to, talked to, properly paid etc., is one of the prime jobs of management. Common sense is the only thing required - we have elaborate policies and procedures, there is an abundance of advice available for the asking - all that is required is that the line officers accept the responsibility and actively work at the "people management" dimension of the business. You should know that: (1) I will work to minimize the bureaucratic process (but it won't disappear); (2) I would expect two levels of review on people issues - you should know those working for you and the next layer down; (3) I assume that management is responsible for the environment within which people work; and (4) our existing staff programs are more than adequate for all but exceptional circumstances - but they can be changed and if they should be you should say so.

*If you have not seen these - ask for them.

VII. We are a service business. The quality of our products depend upon their design but even more importantly on the environment within which they are delivered. Our failures stay with us for a long time - our successes are taken for granted. We are all consumers ourselves and understand the dynamics of the problem.

The domestic card activities and the New York Branch system has a service problem - we may well have similar situations elsewhere. The problem it two-fold. First, we are out of balance, that is - we probably have not allocated sufficient resources to customer service and we have probably not truly organized to tackle the problem. Second, and more importantly, we do not have a service attitude. Regardless of resources and organization, there is a potential capacity to delivery service, to smile, to take that one extra step which we do not deliver. We should and must.

There are also a lot of questions to be asked about customer service. How much of our performance depends simply on attitude and leadership? Should all customers be treated the same way - or like the airlines should we develop special service units and facilities for certain groups of customers (even to include special branches). How much service could be delivered by phone? What does staffing level have to do with service? Quality of staffing? If we substantially upgrade customer contact job requirements would the effect pay for itself? What about training?

VIII. It seems highly likely that the pricing of consumer financial services will undergo important changes. At present we deal with our customers through a set of prices that can hardly fail but to leave them with a confused if not somewhat suspicious impression of our business. On the loan side government requirements (in the U.S.) have tended to improve communications, while on the deposit side the typical customer is confronted with a confusing set of alternatives. Since pricing practices are likely to be altered as thrifts become full service competitors and the card develops in conjunction with "core" accounts - both for revolvers and non-revolvers - it would seem to be important to develop a set of attitudes and policies with regard to the alternatives we could face. We have not yet looked into the subject - but we should - with the clear intent that we could lead the industry into a pricing approach that not only would generate appropriate revenues but would also recognize the importance of pricing in communicating with our customers and in revealing the values inherent in the business.

IX. Auditing has tended to be relegated to the Comptrollers. Yet it seems to me that "risk protection" is a line responsibility. These two attitudes are in conflict. I would like to see each Business Manager define - in specific detail - the risks to which the corporation is exposed as a result of the existence of the business effort. These risks should not be limited to those that are strictly financial but should include exposure to legal/regulatory problems - unionization - consumerist issues,etc. Once detailed, this understanding should be translated into a set of management practices and audit programs that will insure appropriate protection for the stockholder. If we do this, I am inclined to believe that we can run our business in a prudent way and that the audit/compliance programs will be more useful, informative and substantially less costly.

Credit is a clearly differentiated class of risk. Our historical experience has not been good. At Princeton, we estimated that in addition to the normal credit and fraud write-offs we had written off some $70MM that was traceable to specific business errors. Yet an analysis leaves the impression that most of our credit problems can be related to one of two problems. First, poorly conceived credit products or second, loss of control of routine collection/receivable management processes. Since this seems to be the case, we are instituting procedures that will require a Group level approval for each and every credit product and routine reporting - in a common format - of the status of receivables. There is no intent to pre-empt and remove these two areas of management from the Business Manager level where they quite correctly rest - there is, however, a need to insure appropriate review and attention to these issues throughout the Group.

X. The notion of a "business proposition" or preception on the part of a given manager of that which has to be created in order to achieve a business success is key to the concept of running a business and distinguishes the manager from the administrator. Presumably, when embraced, a business proposition is fleshed out and fought for as the model of what needs to get done in running our business. It is my impression that we have not yet fully defined nor embraced such propositions at the business level throughout the CSG. We clearly know what business we are in and what objectives we are trying to achieve - yet the balance and tone of each business has still to be fully defined and embraced by business managers throughout the Group. This is a priority task.

It is impossible to make general comments about the marketing dimensions of business propositions - choices as to which segment to target and how to position ourselves within the market are many. The only general rule is that we have not tried to establish the same posture around the world.

Some comment can be made about the financial dynamics of our various businesses - and about the need to manage the trade-offs between volume (share), margins and distribution: (These trade-offs may be central to much of our business activity in the next several years.)

momentum; In general the built in momentum pushes us towards increasing the volume of our business - cutting distribution costs - and leaving margins generally "as they are"

margins; The issues of margins is a tough one yet the previous comments on pricing should make clear that we may well have an opportunity to restructure the business. At least in our "supermarket banking" businesses the current situation is unacceptable - margins are too low and depositors are subsidizing borrowers. By and large margins have not changed (against a long term pool) over the years and the economics of the distribution system is a strong negative. It is also true that the distribution of customers has a strong impact on the average margin manifest in the business and that a small group of customers may well be subsidizing the bulk of the system.

distribution: The card obviously is opening new opportunities for the distribution of consumer financial services -, yet: (a) this is currently very much a U. S, phenonmenon; (b) the use of cards - whether as an attribute of the traditional branch based business or on a stand-alone basis is still undefined as its relative attractiveness for use "in" branches as opposed to "out" of branches;and (c) the current processing underlying the card business is quite uneconomic.

Leaving the card aside, with the exception of pure direct lending offices, we have relatively little feel for the capacity of our distribution systems - hence for their economics. It would seem that the "output" of the distribution system is (a) minutes of transaction time; (b) minutes of service time;and (c) minutes of platform time. The utilization of the output varies greatly throughout the day - and probably between customers. The cost of distribution is very high - on average (worldwide) eating up some 85% of the net revenues provided by customers. While there would seem to be promise of cost reductions - these seem most likely to be available by re-thinking and re-configuring our distribution systems rather than through efficiencies. Such redesign does not stand alone but relates to the fundamental business proposition being supported.

volume (share): In some instances volume (share) is a question of "more of the same". In other cases any material change in volume will involve a significant restatement of our market proposition potentially involving additions to our product lines (e.g., DDA in Belgium and U.K.) or upgrading service levels (e.g., New York ?). While volume as an end in and of itself can be a problem and while there is great concern with adding volume to over-used distribution systems at low margins - in the long run - when we are in balance vis-a-vis margins and distribution, growth must, of course, come from expansion of volume. In the meantime, the situation varies across the businesses.

profitability: The issue of profitability and its fate as the businesses develop is, of course, crucial. The Group plan imposes some boundries on aggregate profit performance and speaks to the issue of pacing, yet it remains true that the trade-offs between margins/volumes/distributions that must be managed business by business cannot be taken without regard to net performance.

- in a number of overseas countries current 1976/77 profits have been sacrificed to develop our business position.

- in Nationwide and more recently Upstate severe restrictions on growth have been necessary to reverse unacceptable losses.

- card efforts have been funded at the cost of current profits to the extent manageable.

<u>XI.</u> In re-reading these notes, it could well be that you are wondering why they were written and why they were sent to you. It seems clear that we must build a community of understanding and commitment. There are some 35 of us - Division Heads, Business Managers, GMO Staff and key operating and marketing officers - who in the aggregate have responsibility to manage the consumer effort. It is fundamentally important that we share views and forge common beliefs in the thrust of our effort. In my mind, we will not succeed unless all of us succeed. It is probably important to say that leadership involves more than target setting and evaluation. Each of us has an active responsibility to make those working for us succeed in their respective responsibilities.

The business managers are clearly key. As described earlier, this job was created as the focal point for day-to-day business responsibilities. The rest of the organization is designed to support this role. Division Heads are strategic managers. They have responsibility to act as "player coaches" with the business managers and insure the success of that effort but, more importantly, they provide an overview of their constituent businesses and give direction to the development of our efforts. The GMO staff, if functioning properly, is an extension of my own office. Ideally, their viewpoint is that of the Group Head. They help me in my job and should not direct the line organization. They do what I would like to do if I had the time or the specific skills. In the aggregate, we are all partners in this effort and must forge the working relationship to reflect that fact.

JR

John S. Reed
Executive Vice President

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