U.S. and European Financial Conglomerate Organizations and their Implications for Japan and Other Large Diversified Financial Firms in Asia

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Abstract

Rapid changes in the global banking structure have resulted from globalization and deregulation of the banking industry as well as disintermediation of banking transactions. Many old banks have ceased to exist or have been renamed. Newer large and diversified financial conglomerates are now the major players in the global market. This paper will examine the management strategy and structure of major US and European financial conglomerates which have diversified into various forms of financial business including commercial banking, securities and other types of non-banking businesses. The paper aims to develop ideas about the implications these organizations hold for Japan and other Asian financial firms.

Keywords: globalization, deregulation, disintermediation, financial conglomerates, strategy and structure

Introduction

Globalization and the Emergence of Financial Conglomerates

The industrial structure of global banking has changed rapidly due to the competitive environment prevailing in the business world. Globalization[1] and deregulation of the industry, as well as disintermediation of banking transactions, have encouraged cutthroat and global-level competition among banking majors. As a result, many old banks have ceased to exist or have undergone a change of name. Newer large and diversified financial conglomerates are now the major players in the global market. The major developments can be summarized as follows.

- The names of most US money center banks have been changed, for example, JPMorgan Chase and Citigroup; while names such as Manufacturers Hanover, Bankers Trust and Chemical Bank are, due to mergers, no longer functional.

[1] Mishkin (2006) defines globalization as the opening of economies to the flow of goods, services, capital and business from other nations that integrate their markets with those abroad (p. 1). This paper follows this definition.

- All US partnership-based major investment banks have become public companies and have diversified their business activities through IPOs and mergers.
  Almost all traditional British merchant banks, including Barings, Morgan Grenfell and SG Warburg, are no more.
- Major European universal banks have diversified and become larger through domestic and crossover mergers and acquisitions, while targeting their banking base in the US financial market.
- Major Japanese bank names have merged into three mega banks, namely, Mitsubishi UFJ, Mitsui Sumitomo and Mizuho, something unheard of five years ago.

These vast changes which have occurred over the last ten years have mostly been initiated in the US, where financial innovation and disintermediation of finance has led to the creation of financial conglomerates. Today, four of the top five largest global financial institutions in terms of market capitalization are US banks (Figure 1).

It is worthwhile examining the changes in the US market first. Large financial firms should expand their businesses so as to ensure that new products are distributed from their present distribution platforms of retail and corporate banking, and move to expand into emerging markets by utilizing their advanced know-how and brand value. They can leverage advanced risk control and information systems which they have developed to manage large corporations efficiently.

Here, we are going to examine the management strategy and structure of major US and European financial conglomerates, firms which have diversified their activities in various financial businesses including commercial banking, securities and other types of non-banking businesses.[2]

Figure 1 Top 20 Global Financial Institutions

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2 Smith & Walter (2003) define financial conglomerates as 'bank-based multifunctional financial organizations' (p. 382).

1. Business Strategies of US Financial Conglomerates and their Impact on Global Financial Markets

US Financial Conglomerates: Are there Managerial Advantages?

Although there is a global trend to development of diversified conglomerate-type financial institutions, management styles differ from country to country. US conglomerates have clearly performed better, perhaps due to organizational advantages. Strategic, organizational or managerial strengths in US financial conglomerates should be revealed by assessing the following:

- Strategies adopted;
- Crucial factors for the efficient management of a financial conglomerate;
- Organizational advantages which make for more efficient management.
- Incentive mechanisms these conglomerates have developed to manage and control human resource more efficiently;
- Monitoring and management of the performance of each strategic unit and individual players;
- Problems in the organizational structure encountered by these conglomerates due to scandals occurring in the last few years.

The Importance of Merger and Acquisition Strategy for a Stronger Institution in a Changing Competitive Environment

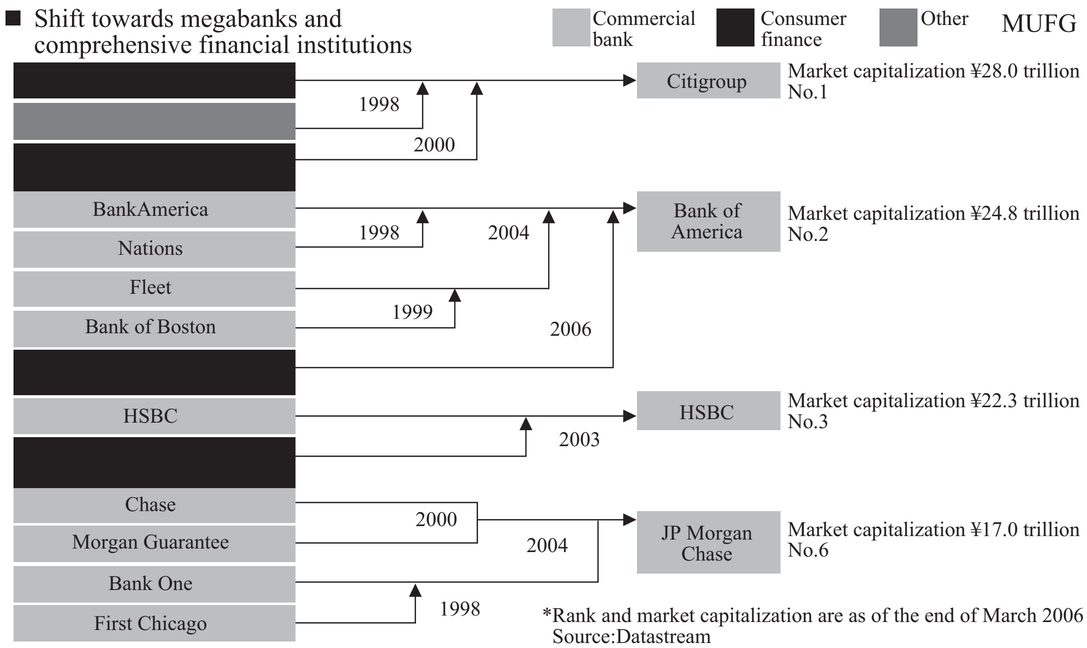
During 1980s and 1990s, the US financial industry enjoyed economic and financial prosperity with active capital market transactions, mergers and acquisitions, corporate restructuring, financial innovations, securitizations and derivatives. The burden of effectively managing this rapid growth was significant for US financial institutions. Thus, a number of US firms including Dillon Read, Bankers Trust, Chase Manhattan, JP Morgan, and Paine Webber found merger with a stronger partner, including European counterparts, the best strategic alternative.[3]

During this period, the major factor in the changing competitive environment were disintermediation of financial intermediaries, deregulation, globalization and new technologies including the development of the Internet. These changes made it difficult for most traditional financial institutions, including relation-based investment banks, to survive. With customers increasingly prepared to pick and choose the best deal, traditional customer relations practices became ineffective and established banks realized they would have to do their business differently. Integrated investment and corporate banking became prevalent in the industry, making many independent firms merge with stronger firms.

In consumer banking, too, scale and cost effectiveness became the most important factor to compete in this environment. This resulted in the establishment of new financial conglomerates in the late 1990s and early 2000s – namely, Citigroup, JPMorgan Chase and HSBC (Figure 2).

[3] Smith & Walter (2003), pp. 398-401.

Figure 2 Mergers of Top Four Global Financial Conglomerates



Source: <http://www.mufg.jp/english/ir/presentation/>.

1-1. Reasons US Financial Institutions Become Larger and More Diversified

Internal Reasons

A bank manager's ability to adapt to a competitive environment induces the bank to become large and diversified. Four major factors influencing the growth of a bank are:
(a) Economical and efficient operation;
(b) Maximized economy of scale and scope;
(c) Maximized shareholders value and increase of market power; and
(d) The too big to fail strategy.[4]

<u>(a) Efficient Operations through M&A</u>
Through merger and acquisition (M&A), US financial institutions eliminate duplicate operations and dismiss surplus employees. The operation is consolidated in the most effective manner, dramatically improving cost efficiency. Bank management executes major cost cuts improving profitability swiftly through M&A.

<u>(b) Economy of Scale and Scope</u>
The effect of economy of scale is significant for back office operations in retail, the settlement business, IT and other technology investments. This effect is immense in financial institutions because of large fixed costs in their IT and operation areas.

Theoretically, there is economy of scope by selling various financial products such as deposit, brokerage and insurance to the same customer at a banking branch or on the Internet. This is why many large commercial banks have diversified into

[4] Rose & Hudgins (2005), pp. 93-96.

wholesale, investment banking, brokerage and insurance businesses through mergers and acquisitions. The idea of one stop shopping is prevalent among US financial institutions. However, research shows that though there may be economy of scope in selling different products, it is negligible when different financial products are produced in the same institution.[5]

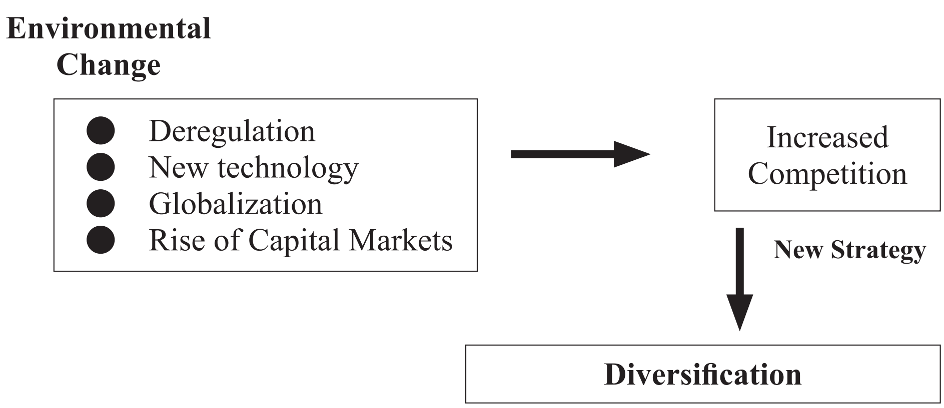
(c) Increase in Shareholders' Value and Market Power
Managers of large banks have a major incentive to expand their activities through M&A because their market value increases immediately after the announcement of such transactions. Compensation levels for managerial staff at almost all large US financial institutions are tied to stock price through stock options. Moreover, by becoming bigger, market power is increased as size means a lot in the banking industry. In some cases, these incentive structures result in moral hazards for managers.

(d) The Too Big to Fail Strategy
Financial organizations will try to become larger as this strategy ensures that the regulator will not allow an immense institution to fail, largely due to the effects failure would have on the public.

Outside Pressure

The competitive environment in the financial industry encourages banks to diversify into new business areas. Factors which increase competition are deregulation, new technology, globalization and the rise of the capital market. To address these issues, large banks try to retain corporate and individual customers, spread risk across different businesses, level their income streams, achieve economy of scale and scope and attain synergies from product diversity and cross-selling.

Figure 3 Competitive Environment and Pressure to Diversify



Source: Figure prepared by author.

[5] Nowadays, many large bank conglomerates separate their insurance business and sell diversified insurance from different insurance companies. As discussed later in the case study, Citigroup, after merging with Citibank and Travelers which was involved in investment banking, brokerage and insurance, divested its insurance business because it was more beneficial to sell different insurance products of various other insurance companies rather than selling their own products.

Performance of US Financial Conglomerates

Citigroup, Bank of America and JPMorgan Chase expanded their asset size tremendously during 2001-2005 through mergers and acquisitions. The profitability of Citigroup has been stable with a ROE of around 19%, high compared to the industry standard. Bank of America's performance has been good but slightly unstable. Its ROA surpasses that of Citigroup because it focuses on a riskier retail portfolio. JPMorgan Chase's performance has been unstable and lags behind that of its two competitors. This can be explained by its failure to properly integrate its investment banking business into its group structure, although it did merge with Bank One in order to strengthen its capability in consumer banking. Overall, the performances of Citigroup and Bank of America surpass those of other global financial conglomerates.

Table 1 Comparative Performance of Three Financial Conglomerates

		2001	2002	2003	2004	2005
Total Assets Million $	Citigroup	1051450	1097190	1264032	1484101	1494037
	Bank of America	621764	660458	736445	1110457	1291803
	JPMorgan Chase	693575	758800	770248	1157248	1198942
Net Income Million $	Citigroup	14284	13448	17853	17046	19806
	Bank of America	6792	9249	10810	14143	16465
	JPMorgan Chase	1719	1633	6719	4466	8483
ROA %	Citigroup	1.5	1.2	1.5	1.2	1.3
	Bank of America	1.1	1.4	1.5	1.5	1.4
	JPMorgan Chase	0.2	0.2	0.9	0.5	0.7
ROE %	Citigroup	19.7	16.2	19.5	16.6	18
	Bank of America	14.1	18.7	22	19.2	16.4
	JPMorgan Chase	4.1	4	15.4	5.9	8

Source: Table prepared by author from data collated from Standard and Poor's industrial survey.

1-2. Research and Surveys Regarding the Efficiency of Large US Financial Institutions

A tremendous amount of academic research has been done on the economy of scale of large commercial banks in the US.[6] Most of this research concludes that there is no economy of scale effect once the size of the bank has reached a particular asset level, i.e., around that of a present mid-sized US bank. These research results show that there is no economic basis for the recent emergence of large financial conglomerates.

Smith (2001) summarized various studies, the data of which indicates the low success rate of large mergers and finds negligible economy of scale and almost no economy of scope. According to Smith, the limited efficiency gains from bank mergers leaves to management the burden of showing that net new economic value is created by large multi-product mergers. To sustain margins, firms have to take advantage of their abilities to maneuver between product lines and world markets and to make the most of their competitive advantage, know-how, and market franchise value.

[6] Refer to Kuhara (2000) for details of the survey on M&A and efficiency of US financial institutions.

These research results show that the success of a financial conglomerate depends on the capability of management as well as the efficiency of firm operations. It is important to look into case studies on US and European financial conglomerates and their running.

Bankers must carefully consider whether their organizational structures, controls, and compensation policies are appropriate for the new environment of global competition.

1-3. The Organizational Structure of Large and Diversified Financial Institutions

The organizational structure of a financial conglomerate depends on its historical, regulatory and managerial environments, and takes one of the following three forms: Universal Bank, Holding Company, or Bank Subsidiary.

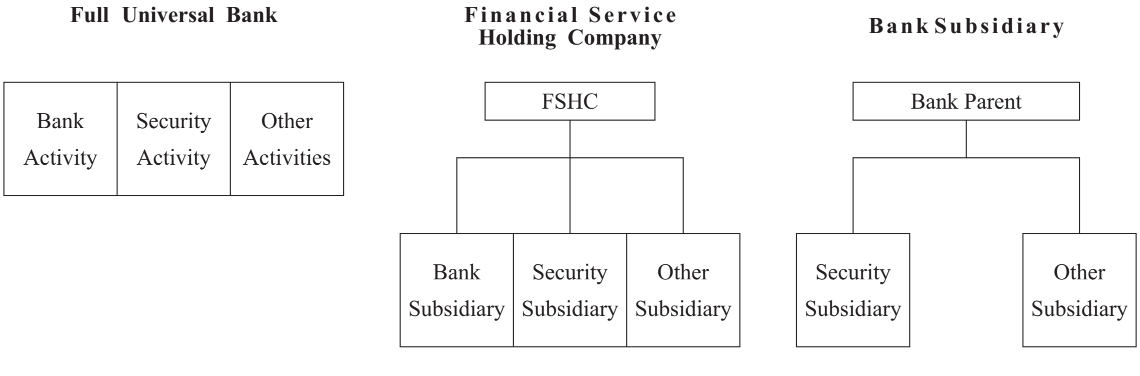
US financial conglomerates adopt the Financial Service Holding Company structure. Most continental European firms adopt the Universal Bank structure.

The organizational structure determines how efficiently the bank can manage a diversified business. Firms diversify in order to attain cost and revenue synergies, stabilize earnings and reduce risk. To achieve this this, firms should balance centralization and decentralization of various functions within the organization. Centralization decreases transaction costs, an economy of scale and scope; while decentralization decreases agency costs, delegating management closer to operational level.[7]

When examining diversification options, issues related to the organizational structure should be considered. These include the balance between centralization and decentralization, safety and soundness of banking, economies of scale and scope, conflict of interest, deposit insurance issues, regulatory oversight and competition issues.[8] As a diversified organization the most important concern is organizational efficiency.

By studying cases of US and European financial conglomerates, the following sections will analyze efficiency issues relating to these organizational structures.

Figure 4 Three Forms of Organizational Structure of Financial Conglomerates



Source: Figure prepared by author.

[7] Yidrim (2005), pp. 13-17.
[8] Yidrim (2005), pp. 33-34.

The universal bank structure runs different businesses as divisions under one bank organization. This structure increases the synergy effects through the balance of centralization and decentralization, but has potential problem issues regarding conflicts of interest [9] among different businesses. Most European banks follow this structure for historical and regulatory reasons. In the US, the adoption of this structure is prohibited for regulatory reasons.

For banks in the US, where regulatory restrictions prohibit the universal bank structure, the holding company structure is standard[10] and now most large US financial conglomerates are organized as Financial Service Holding Companies.[11] This structure facilitates separation of different businesses and helps avoid conflict of interest problems. However, not much economic efficiency is gained, owing to the lack of synergetic effects between the separated subsidiaries. Through our research we found that although many US financial conglomerates follow this structure on the surface, actual management is run by strategic business units, regardless of the legal structure, in order to attain organizational efficiency and to balance centralization and decentralization of business. Details will be discussed in the case studies below.

The bank subsidiary structure is one in which the parent bank directly owns various non-bank subsidiaries eliminating conflict of interest issues and increasing synergy.

The actual structure of a large financial conglomerate, categorized into one of the three models above, depends on the regulatory environment and the balance of centralization and decentralization. It is interesting to find that most firms actually run their operations in the manner of a strategic business unit in order to attain the agility and efficient management systems of large institutions, no matter what their legal structure.

1-4. Case Study: Strategy and Organization of Large US Financial Conglomerates

Analyzed here are the strategies and organization of three large US financial conglomerates: Citigroup, JPMorgan Chase and Bank of America, based on their homepage data and magazine articles.

1-4-1. Citigroup

<u>Birth of the Financial Conglomerate</u>

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[9] Conflict of interests (resulting in large losses to investors and depositors due to lower company profits) in financial firms occur, for example, when the firm has to sell an affiliate's products, salespeople will be pushed to sell those products although the benefit to the customer might be smaller compared to that of other products. Also, a financial firms acting as an underwriter will push its analyst to rate the securities they underwrite higher, to recommend to its customers. A bank with a loan outstanding to a customer and knowledge of the customer's bankruptcy, may issue security to replace the loan outstanding, resulting in investor loss.

[10] In Europe, the holding company form is not often used in banking except in the Netherlands and Italy: Rose & Hudgins (2005), p. 87.

[11] By the introduction of the Gramm-Leach-Bleily Act, large US banks are allowed to have security and insurance businesses together with commercial banking under the same financial service holding company.

The announcement in April 1988 of a merger between Citicorp and Travelers group resulted in the birth the first financial conglomerate in the US, Citicorp, in October, 1998. This is the first US case in which a commercial bank and an insurance and brokerage firm merged to expand their operations to include a wide range of bank and non-bank activities. The merged group's total assets, $700 billion, were the largest in the US and the conglomerate had offices in 40 different countries. The largest issuer of credit cards diversified into brokerage, commercial and investment banking and services, insurance, and consumer and business credit.

Under the 1933 Glass-Steagall Act, US commercial banks were prohibited from doing commercial banking and underwriting business in the same organization. However, the 1999 Gramm-Leach-Bleily Act made it possible for US financial institutions to become conglomerates operating banking, underwriting and insurance businesses under the financial holding company structure. The development of the Citicorp and Travelers merger prompted the realization of the new law allowing financial conglomerates.[12]

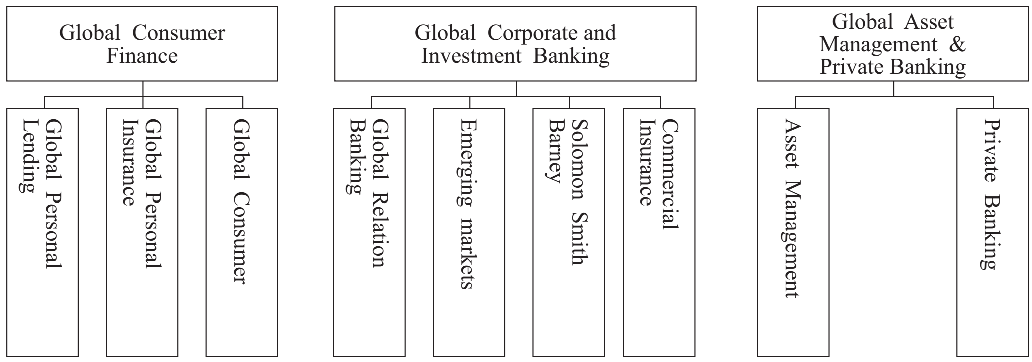
The strategy of Citigroup when merged was to focus on businesses of commercial, consumer and investment banking, credit cards, security brokerage, asset management, life and casualty insurance.

The three core businesses determined were:

1. Global Private Finance;
2. Global Corporate Finance and Investment Banking; and
3. Asset Management (Figure 5).

The success of this conglomerate would depend on how it could materialize the benefits of cross-sell, those of banking, security and insurance products, to the same customer.

Figure 5 Three Core Businesses of Citigroup when Merged



Source: Citigroup Annual Report 2000.

Brief History after Merger

After Citigroup acquired Associates First Capital in 2000 and Mexico's Banamex-Accival, European American Bank and Bank Handlowy followed in 2001. Expansion through continuous acquisition and aligning the bottom line through restructuring of acquired firms was a basic strategy of Citigroup to enhance shareholders' value.[13]

[12] Geisst (2005), pp. 269-272.

[13] Weill and Kraushaar (2006), pp. 373-386.

Under the strong leadership of Sandy Weill, restructuring of the organization and management hierarchy was swift. Most former Citicorp senior management, including Citibank CEO John Read, left the group. Many department heads were replaced by former Travelers senior officials. Citigroup attained good financial performance after the merger[14] with its major sources of higher profit coming from the consumer and retail businesses.

In January 2005, Citigroup sold its core business of life and casualty insurance because of the low profitability of that division. CEO Weill refocused the group's activities by reorganizing its insurance business from producing and selling the products to only selling them.[15] This demonstrates failure to find cross-sell synergy between the consumer banking platform and insurance products originated by the group.

The Present Organizational Structure of Citigroup

As of July 2006, Citigroup is organized into three major business groups (Table 2):
1. Global Consumer;
2. Corporate and Investment Banking; and
3. Global Wealth Management, in addition to one stand alone business, Citigroup Alternative Investment.

Table 2 Present Strategic Business Groups of Citigroup (July 2006)

Citigroup Global Consumer Group
Corporate and Investment Banking
Global Wealth Management
Citigroup Alternative Investments

Source: <http://www.citigroup.com/citigroup/business/index.htm>.

Source: <http://www.citigroup.com/citigroup/business/index.htm>.

The Citigroup Global Consumer business provides various consumer products including banking services, credit cards, loans and insurance. The Corporate and Investment Banking business serves investment banking and advisory requirements of clients in about 100 countries. The Global Wealth Management group comprises The Citigroup Private Bank, Smith Barney, and Citigroup Investment Research (which was separated from the Investment Banking group after the 2002 research scandal).

Legally, Citigroup is organized under the financial holding service company, Citigroup Inc., which has several subsidiaries and affiliated companies under its

[14] Weill and Kraushaar (2006) describe Sandy Weill's management capability well.

[15] According to the 2004 Annual Report, Sandy Weill stated the following: "During the 1980s and 1990s, it seemed to many of us that the model for the future of financial services was one that combined the manufacturing of financial products with their distribution. With the emergence and growth of the concept of 'open architecture' since then, it is becoming obvious that for a large global company like Citigroup, distribution is the more powerful asset, with potentially higher returns at times than manufacturing. For this reason, the global model for the industry is changing to one that favors distribution. That led us to spin off Travelers Property Casualty in 2002 and agree to sell Travelers Life & Annuity early in 2005 to reinvest capital in higher-growth, higher-return opportunities. Others in our industry are now reaching similar conclusions. The fact is, there is not and will never be a timeless business model for this or any other industry-models are always subject to change, and no company can afford to keep its head in the sand."

umbrella. These companies were acquired or merged through M&A transactions. The subsidiaries and affiliates are controlled by one of the four CEOs of the group. Legal and business structures are identical in some cases, but not in others. Regardless of the legal structure, Citigroup is run according to the business group structure, assuming each group as an independent company. Because of the size, diversity of business and geographical location, it is difficult to control the organization without decentralized independent business divisions. Managers' responsibility, reporting lines and resource and profit allocation determine the borders between business divisions.

Table 3 Organizational Structure of Citigroup as of October 2006

Holding Company	Business Group	Sub Group	Major Legal Entity
Citigroup Inc.	Global Consumer Group	● US Cards ● US Retail Distribution ● US Consumer Lending ● Commercial Business Group ● International Cards ● International Consumer ● Finance ● International Retail Banking ● Women and Company	● Citibank ● Citi Financial ● Priamerica Financial ● Services ● Citi Mortgage ● Citi Capital ● Banamex
	Corporate and Investment Banking	● Global Banking ● Global Capital Markets ● Transaction Services	● Citigroup Global Markets Inc.
	Global Wealth Management	● The Citigroup Private ● Banking ● Smith Barney ● Citigroup Investment ● Research	● Citigroup Private Banking ● Smith Barney
	Citigroup Alternative Investment		● Citigroup Private Equity ● Citigroup Venture ● Capital International ● Citigroup Property ● Investors

Source: Table prepared by author from information at <http://www.citigroup.com/citigroup/about/>.

Management Problems of Large Organizations and Irregularities

In the investment banking business many irregularities were revealed under the aggressive culture of Citicorp Investment Banking and former Salomon Brothers. These irregularities included manipulation of accounting results for Enron, WorldCom and other emerging companies, and conflict of interest between underwriting and research and IPO stock splitting. Citigroup also paid $4950 million for legal expenses concerning these wrongdoings.

Quotes regarding these offences are reproduced below:

> The aggressive culture inherited from Sandy Weill is hurting the reputation of the Mega bank.[16]

[16] *Business Week,* October 4, 2004.

> We won't say we are never going to make a mistake, but we have a keen focus on not being in the headlines. We're going to be judged on whether we meet that standard or not. (Chuck Price, CEO, July 2003)[17]
>
> Citigroup's aggressive profit incentives are overriding judgment." (Guy Mozkowski, Bank Analyst, Merrill Lynch & Co.)[18]

In addition, wrongdoings were revealed in the group's global operations. In August 2004, the British Financial Service Authority unearthed the bond trading scandal. Citigroup apologized for what had happened. Within weeks, in September 2004, Japanese authorities ordered the group to shut down its local private bank. Investigations had revealed extensive legal violations over seven years, including lax governance and money laundering. Japan's Finance Ministry banned Citigroup from participating in its government auctions.[19] The major cause of these global scandals was the organizational structure, with local professionals reporting through local middle managers in that particular business group to their division heads in the US headquarters. Local management in London or Tokyo had no authority to supervise these businesses.

After the scandal in its US investment banking arm, Citigroup reached final agreements with the New York State Attorney General and regulators to resolve outstanding investigations into research, IPO allocation and distribution practices.

The main reason for these problems stems from the fact that the organization is too vast to manage with emphasis on large profits and few controls.[20] Sandy Weill quickly focused on solving these problems by strengthening business and internal controls. Consumer and retail finance, which garnered 60% of group profit, was prioritized. After these various scandals, Weill was succeeded by Charles Prince.

<u>Summary</u>

Citigroup's decentralized organizational structure makes it difficult to know what is happening at the operational level. However, once problems were revealed, the organization functioned well to resolve them and change direction, complying with laws and regulations. The corporate governance structure of an independent board also facilitated the quick change in strategic direction.

Citigroup might be better managed if it were to be divided into focused individual sections, each headed by a more capable leader. CEO Chuck Prince is faced with several challenges as mentioned in this extract:

> Prince has faced one crisis after another during his three-year reign, from run-ins with regulators on three continents to shareholder lawsuits over Enron and WorldCom.
>
> That's all behind him now. But he's not home free. And Prince is facing his biggest crisis ever – one of confidence in his leadership and his ability to steer a trillion-dollar empire toward desperately needed new growth. Profits have fallen short of analysts' estimates in four out of the last five quarters, and the stock has been stagnant for about three years. With the ethics issues resolved, some people are wondering whether Prince's focus on rules and regulations is stifling the vitality of the company.

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[17] *Business Week,* October 4, 2004.
[18] *Business Week,* October 4, 2004.
[19] *Business Week,* October 4, 2004.
[20] Despite the problems, Citigroup had good returns due to high profitability of its retail businesses.

> Prince's strongest critics think the best way to spur growth is to break up the financial behemoth. Prince is dead set against it, but money manager William Smith of SAM Advisors in New York proposes splitting the bank into three parts: retail, investment banking, and global operations. He figures a breakup could push the stock to 66 immediately, from 51 today, and to 90 in two years.[21]

In conclusion, US financial conglomerates may have structural problems caused by being too big to manage, but with strong leadership, failures can be dealt with quickly through management power.

1-4-2. JPMorgan Chase

<u>Merger of JP Morgan and Chase</u>

JP Morgan had been a prestigious US financial institution, building up US industry through its relationship-based corporate finance. JP Morgan Securities had been a strong player in government security underwriting and trading. As a united organization, JP Morgan controlled all market risks in banking and security subsidiary while providing diversified services in commercial banking and investment banking to the same customers. This had been achieved through efficient management and a risk control structure ensuring legal compliance, separating the banking and security businesses. With this experience, JP Morgan developed a total risk control system of a diversified finance business called VaR (Value at Risk).[22] The system became the standard for total risk control and capital allocation of modern banking.[23]

With only graduates from Ivy League universities joining JP Morgan, the bank developed an elite culture which grew impractical during the competitive 1990s as customers turned to capital markets transaction banking. In order to survive, JP Morgan decided to merge with another large financial institution.

New York's Chase Manhattan, originally established by the Rockefeller family, was a typical money center bank. Finding it difficult to exist on its own, the bank was acquired in the late 80s by Chemical Bank, a well-managed money center bank, strong in the market and in business trading. Although Chase Manhattan was taken over by Chemical Bank, it was decided to keep the strong brand name of Chase. In 1997, Chase Manhattan became the US bank with the greatest volume of assets. Its two main businesses were global corporate banking and nationwide US consumer banking.

Then, JP Morgan and the former Chemical Bank merged to make JPMorgan Chase, a strong franchise in the corporate finance and retail network as well as trading activities. However, the organization could not attain comparative profit performance because its investment banking was not as strong as that of specialized investment banking players like Goldman Sachs or Morgan Stanley. Also, their advisory business of M&A, underwriting of IPOs and retail business were not as efficient as those of

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[21] *Business Week,* October 5, 2006.

[22] Value at Risk is the method of united risk control system developed at JP Morgan. Under this system, the whole portfolio of banking business is translated into potential and maximum risk capital through a statistical method reflecting past data. This risk control method became the standard for global banking during the 1990s.

[23] Kuhara (1997).

Citigroup and other large commercial banks.

In order to improve profitability and expand its retail business, JPMorgan Chase acquired Bank One, a merger product of former First Chicago, National Bank of Detroit and Bank One, with the capable Jamie Dimon as CEO.[24] After leaving Citigroup in 2001 as a result of a disagreement with Sandy Weill, Dimon was recruited by Bank One in 2003. Dimon restructured Bank One's management, making it a profitable retail bank under his leadership and his management team brought from Citigroup.[25] The merger of JPMorgan Chase & Co. and Bank One, completed in July 2004, created one of the largest financial services companies.

The present JPMorgan Chase is a product of many mergers with its investment banking headquarters and security business in New York, while its consumer and corporate banking business is in Chicago.[26] Its CEO Jamie Dimon is young, having the ability to lead this diversified bank with a focused strategy ensuring success. [27]

How could a financial firm such as this continue to function with so many mergers? There are two reasons why this bank does well. Firstly, with every merger or acquisition the stronger players of the dominant business remained and weaker personnel were dismissed. This restructuring process results in improvement of the business as well as achieving cost savings. Secondly, the success of large merged organizations depends on the capability of their top management. This was the case of Citigroup and JPMorgan Chase where strong leadership, the crucial factor for economic success, instituted effective cost cuts and restructuring.

Strategy and Organization of JPMorgan Chase

In the merged firm, investment banking is looked after by JP Morgan, commercial banking by the former Chase, and the retail and credit card business by Bank One. The organization is divided into the following six strategic business units (Table 4).

Table 4 JPMorgan Chase: Six Lines of Business (October, 2006)

Business Lines	Brand	Major Subsidiary
Investment Bank	JPMorgan	JPMorgan Securities
Retail Financial Services	Chase	
Card Services	Chase	Chase USA
Commercial Banking	Chase	JPMorgan Chase Bank
Asset & Wealth Management	JPMorgan	
Treasury & Securities Services	JPMorgan	JPMorgan Securities

Source:<http://www.jpmorganchase.com/cm/cs?pagename=Chase/Href&urlname=jpmc/about>.

[24] Mara Der Hovanesian. 2005. "Dimon's Grand Design". *Business Week*, March 28, 2005.

[25] Kuhara (2003).

[26] It is worth looking at which players among the merged banks grasped power in each business. Most often, those of the dominant firm took over operations of the newly formed bank. For example, in the case of the merger between Chemical and Chase, Chemical's people took the power of management and most of the market and corporate businesses. Players, formerly those of Chase Manhattan, left the new bank. Also, when JP Morgan and Chase merged, former Chase people (originally Chemical's) took control of management. In most US bank mergers, there is a distinct power shift which makes cost cutting though merger easy. However, with bank mergers in Japan, both parties stay and share management responsibilities, making the organization inefficient after the merger Kuhara (2000).

[27] Mara Der Hovanesian "Dimon's Grand Design", *Business Week,* March 28, 2005.

Summary

In both consumer and corporate banking, the merged company has attained a sizable market share. However, its performance has been unstable and lags behind that of its competitors. In consumer banking the firm is not as strong as its competitors in terms of branch networks and product base. In the investment banking business where former JP Morgan had a competitive advantage with their quality of services to large corporations, players like Goldman Sachs and Morgan Stanley have taken over. This may have been due to a failure to attract talented professionals to retain the company's investment banking culture. The difficulty in achieving synergy between commercial and investment banking is clear. What is interesting is the strategy of utilizing former franchise value. CEO Dimon has excellent capability to manage a complex organization, but whether he will succeed or not is yet to be seen.

1-4-3. Bank of America

History and Overview

Bank of America (BOA), the chief rival of Citibank, has branch networks in several countries and was considered the major international bank in foreign exchange and trade finance. During the 1980s, faced with a decline in profitability, the bank dismantled many of its international business operations, focusing instead on domestic business. Nations Bank, the leading regional bank, acquired BOA in 1988 and its headquarters were moved from San Francisco to Charlotte, North Carolina, where Nations Bank had its head office. Since then, BOA has become a large domestic bank with retail business in the most US states and a significant share of domestic securities underwriting and related businesses.

Today, BOA is the second largest financial institution in the world after Citigroup (Chart 1). It is the largest commercial bank in the US (although Citigroup has greater assets worldwide). In July 2006, BOA reported a second quarter 2006 net income of $5.48 billion, surpassing that of Citigroup for the first time.

The firm's investment banking activities were conducted through its subsidiary, Bank of America Securities. Their acquisitions, West Coast based investment banks Robertson Stevens and Montgomery Securities, specialized in West Coast investment banking and brokerage businesses during the late 90s; after the dot com bubble burst in 2000, however, their activities declined. The firm has no insurance businesses.

Core Business

Bank of America's core business is consumer and small business, supported by the largest retail network in the US[28] They have a strong Internet banking arm whose top Internet site is listed as one of the best.[29]

On January 2006 the bank announced it would purchase credit card giant MBNA for $35 billion in cash and stock. The completion of the deal will solidify the bank's

[28] The company provides unmatched convenience in the US, serving more than 54 million consumer and small business relationships with more than 5,700 retail banking offices, 17,000 ATMs and online banking having 19.8 million active users. BOA is the No. 1 overall Small Business Administration (SBA) lender in the US and the No. 1 SBA lender to minority-owned small businesses.

[29] BOA is a leading provider of online financial services, and its online site, <http://www.bankofamerica.com/>, has received widespread recognition. According to Financial Insights, the bank has the most number of online bankers in the world. The site is listed among the top 50 of all US-based Internet

position as the largest issuer of credit cards in the US, surpassing rival JPMorgan Chase.

Structure

Under the bank holding company arm of Bank of America Corporation, there are various subsidiaries in banking and non-banking activities. Besides this legal organizational structure, the bank has four strategic business divisions each run by a group president. Though described as global, these activities focus on international business for US domestic customers.

The four business divisions are: Global Consumer and Small Business Banking; Global Wealth and Investment Management; Global Business and Financial Services; and Global Capital Markets and Investment Banking.

Organization Executive Structure

Nine senior executive officers are responsible for the management of the group. Chairman and CEO, Kenneth D. Lewis, was formerly CEO of Nations Bank.

At head office, there are four senior administrative officers in charge of risk (Nations), finance (BOA), technology (BOA) and administration (Nations).

Three executives are presidents of each strategic business unit, i.e., President, Global Consumer and Small Business Banking (BOA); President, Global Wealth and Investment Management (Fleet Boston); and Vice Chairman and President, Global Corporate and Investment Banking (Nations).

The executive structure utilizes those from former institutions with competitive advantage. Former BOA was a strong player in consumer and small business and the head of this unit is from the bank. Fleet Boston, which was acquired by BOA, was strong in asset management and treasury business. The merger combined the strengths of the previous institution, but the top management is from Nations Bank and from banks acquired by it.

Summary

BOA focuses on its retail distribution network in the domestic US market. Its performance has been excellent. The bank's global franchise weakened after its takeover by Nations Bank because the major management from Nations, a regional bank, did not have the capability to run a large investment bank operation globally. Consequently, its investment banking arm is not as strong as that of its competitors. The bank sells a variety of retail products to customers through a good distribution network. However, international competition will urge large financial conglomerates to diversify more into the global market with growing emerging markets in retail and investment banking – a challenge for the bank in the future.

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properties in terms of visitors monthly, and is No. 1 among business and finance sites, according to comScore Media Metrix. BOA ranked No.1 in Javelin Strategy & Research's Identity Fraud Safety Scorecard in 2004 and 2005. Business Week called the SiteKey™ security service one of the best products of 2005. The bank won the Webby Award and Webby People's Choice Award in 2006 in the online banking/bill pay category. Global Finance magazine named bankofamerica.com the best consumer online banking site in North America and ranked the bank No. 1 for its online investment management services, bill payment and presentment, information security initiatives and integrated consumer bank site. In 2006, Nielsen/NetRatings said BOA is the top online full-service bank destination in terms of audience, page views and active reach on the site. In 2005, the site was ranked among the Forbes Best of the Web.

1-4-4. Summary of Case Studies of US Banks

Multi-Divisional Structure prevalent in US Conglomerates

Although the structure of diversified US financial conglomerates discussed here follows that of the financial service holding company for legal and regulatory reasons, the actual organizational structure for managing large and diversified conglomerates differs at each firm. Basically, all establish a kind of multi-divisional structure by setting up decentralized independent strategic business group organizations.

These financial conglomerates focus on strategy, emphasizing strengths. The organization is divided into strategic business groups, with management running each group in a decentralized structure. The top leadership's commitment to focused business is crucial, as is strict risk control of these diversified and decentralized businesses. Often, top management has hands-on control of star teams or players producing huge profits. It is difficult to imagine diversification in an inflexible environment as that of Japanese financial conglomerates.

In a multi-divisional structure, the decision making of each business unit is decentralized and is closer to the customer. This reduces the scale of internal complexity of each division, thus containing transaction and agency costs. The sharing of customer, production and technology platforms establishes interdependence of divisions. Headquarters can concentrate on strategic issues and allocation of resources and risk control. Operational strategies as well as human resource management are basically decentralized to enable quick response to changes in the market and for customers to be easily attained.

Synergy Management

According to Rogers, there are three types of synergies in financial conglomerates.[30]

1. Synergy in Retail Business

This synergy is easy to manage because retail franchises having a customer platform can cross-sell various retail products like deposits, mutual funds and insurance. It is important to establish technological and information infrastructure for such cross-selling and have well-aligned incentive schemes for salespeople.

2. Synergy in Wholesale Business

The success of this is based on investment bankers and how they can team up to pursue projects for customers. It is important to design a good compensation sharing system as well as a corporate culture which encourages team work.

3. Synergy between Wholesale and Retail Businesses

This is the most difficult to manage with most financial conglomerates failing to find synergy in this area.

Case studies of US firms show that the first type of synergy is successfully achieved through cross-selling with strong nationwide retail and distribution networks. Citigroup uses Smith Barney's brokerage network for this purpose.

To a lesser degree, there is good synergy within the wholesale business due to selling of different services and products to corporate customers. JPMorgan Chase seems the most successful in this area.

Former large commercial banks which diversified into corporate businesses have advantages over competitors like Goldman Sachs, Morgan Stanley and Merrill Lynch

[30] Rogers (1999), p. 204.

mainly because banks have the capability to leverage a strong balance sheet. Their huge capital base also benefits them in underwriting corporate bonds and equities.

There is no clear case of successful synergy between wholesale and retail businesses. Differences in culture and compensation systems make it difficult to achieve such synergy. It is interesting to note that the stock market is urging Citigroup to separate these businesses to increase profitability and the stock price.[31]

Difficulties in Managing Investment Banking

Investment banking businesses were added to many US commercial banks through mergers and acquisitions. However, many problems have emerged due to the difficulty in managing these kinds of businesses. Investment banking business requires a flat, decentralized, organic and self-designing organization with an entrepreneurial culture for good performance. These traits are not in keeping with those of traditional commercial banking, which is based more on bureaucracy. The essence of managing effective investment banking is to customize financial products and services, involving various product specialists joining together in collaborative teams. Investment bankers have minimum commitment to the firm with which they currently work, always looking for opportunities to move to the highest payer. They do not like to be managed, preferring as much autonomy as possible.[32] This kind of individual can only be managed by professional managers in investment banking. Wholesale and retail financial service businesses have such different cultures and modes of operations that they are inherently incompatible within the same enterprise.

It is important for traditional commercial banks to change their culture and incentive structures when entering into new activities. This calls for adjustment of organizational, compensation and control structures.[33]

Each institution should care implicitly about its reputation, establishing an employee code of conduct while expecting strict adherence to industry rules and regulations. However, in most institutions, incentive designs of profit-making players are asymmetric to overall profits and risks. Players have a major incentive to take more risks. If not successful, they move to another firm. The top leadership of US financial conglomerates is faced with two challenges, one from shareholders and the other from star players who stay loyal for profits, not to the firm *per se*.

Importance of Managerial Capabilities to Realize Synergetic Organizational Efficiencies

The huge size of businesses as well as diversified products and markets has made it difficult to manage firms efficiently. Case studies of US conglomerates show that it is crucial that management has the capability to manage large and complicated organizations. Middle management should also be efficient. Financial firms in the US have the advantage of a good market of senior and middle management. The multi-divisional nature of these firms encourages the growth of managerial talent with each division being managed like an independent financial firm on a smaller scale.

Managerial capabilities include:[34]

[31] *Business Week,* October 5, 2006.
[32] Smith and Walter (2003) predict that the wholesale banking business organization, after experiencing control problems of a large organization, might go back to the small, specialized boutique organization (p. 411).
[33] Rajan (1996).
[34] Yidrim (2005), pp. 33-35.

- Identifying the firm's core competence;
- Transferring old resources onto new combinations of products for a competitive advantage;
- Allocating fixed cost to different products;
- Merging the cultures of different divisions;
- Transferring managerial know-how from traditional to new markets;
- Realizing economy of scale and scope;
- Sharing managerial know-how, valuation systems and the management of the firm.

Shareholder pressure for stable and higher profits is immense at US financial conglomerates, making for top leadership discipline. Although Sandy Weill says he ran the Citigroup from the long term perspective of growth, his daily hands-on management style, observing various risks and avoiding higher risk-taking in divisions like propriety trading, shows the focus of management leading the organization[35] – in this case, stable returns for shareholders and higher value from the stock market.

2. European Experiences in Financial Conglomerates under the Environment of Economic Integrations

2-1. European Universal Banks

Historically, European continental banks had been allowed to diversify in banking, security underwriting and other non-bank businesses within one arm. This structure, known as the universal banking structure, allows for one organization with different businesses. Its simplicity makes for more efficient management and operation of the bank organization. The universal banking structure also encourages synergy between divisions. The bank holding company structure adopted in the US for regulatory and other reasons does not have these organizational advantages.[36]

According to analysis by McKinsey which can be summarized as follows, The European corporate and investment banking scenario is excellent with even better prospects for the future:

- Europe's corporate and investment banks – aided by innovation, rapidly expanding capital markets, and strategies emphasizing core strengths – have performed impressively over the last decade;
- Many trends seem likely to continue, but industry leaders worry about the risks of cyclical overheating and remaining structural challenges;
- Industry leaders would be wise to plan for reduced returns from fixed income and for a more demanding hedge fund business;
- They also should expect continuing tensions between advisers and principals, intense competition in the middle market, and the greatest success to accrue to those firms that attract the best talent.[37]

However as the following table shows, financial conglomerates like Credit Suisse and Deutsche bank failed to manage their investment banking in the US market,

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[35] Weill and Kraushaar (2006), pp. 329-333.

[36] According to the Financial Conglomerate Directives of the EU (2002), financial conglomerate structures permitted in the EU are (1) universal bank, (2) bank subsidiary, (3) holding company, and (4) horizontal (no equity relations).

[37] "Outlook for European Corporate and Investment Banking". *The McKinsey Quarterly*, October 8, 2006.

incurring huge losses when the IT bubble burst. Banks strong in the retail market like HSBC and Barclays continued with good performances comparable to that of US conglomerates. Diversified firms like ABN-AMRO, UBS and BNP Paribas performed well.

Table 5 Comparative performance of European Financial Conglomerates

		2001	2002	2003	2004	2005
Total Assets Million $	HSBC Holdings PLC	695877	759246	1034216	1276778	1501970
	Royal Bank of Scotland Group	536725	663320	815124	1120198	1333579
	Barclays PLC	519067	648936	793793	1002359	1586843
	BNP Paribas	734819	745559	987447	1230934	1484258
	UBS AG	754862	854306	1121022	1526333	1563448
	Credit Suisse Group	615861	691229	778216	958573	1016157
	Deutsche Bank AG	817558	795979	1013375	1141434	1170553
	ABN-AMRO Holdings NV	531875	583603	706724	826960	1039156
	BANCO Santander C. HISP	318875	340293	443616	781816	954569
Net Income Million $	HSBC Holdings PLC	5406	6239	8774	11840	15081
	Royal Bank of Scotland Group	3813	4418	6603	8265	10008
	Barclays PLC	3550	3350	4486	5987	6217
	BNP Paribas	3597	3115	4256	5805	7782
	UBS AG	2948	2278	4750	6516	7911
	Credit Suisse Group	941	-2132	3719	4619	4711
	Deutsche Bank AG	334	340	1373	3074	4391
	ABN-AMRO Holdings NV	9033	9307	11003	12022	11343
	BANCO Santander C.HISP	2226	2124	2953	3900	7740
ROA %	HSBC Holdings PLC	0.8	0.9	1	1	1.1
	Royal Bank of Scotland Group	0.5	0.5	0.5	0.8	0.8
	Barclays PLC	0.7	0.6	0.6	0.7	0.5
	BNP Paribas	0.5	0.4	0.5	0.5	0.5
	UBS AG	0.4	0.3	0.5	0.5	0.5
	Credit Suisse Group	0.2	0	0.5	0.5	0.5
	Deutsche Bank AG	0	0	0.2	0.3	0.4
	ABN-AMRO Holdings NV	0.4	0.4	0.5	0.7	0.6
	BANCO Santander C. HISP	0.7	0.6	0.8	0.6	0.9
ROE %	HSBC Holdings PLC	11.8	12.7	13.8	14.7	16.8
	Royal Bank of Scotland Group	7.4	7.2	8.1	14	16.1
	Barclays PLC	17.4	14.7	16.7	19.1	19.8
	BNP Paribas	17.2	12.5	13.4	15.2	16.9
	UBS AG	10.9	8.4	16.7	21.9	24.6
	Credit Suisse Group	5.2	0	17.7	16.4	14.8
	Deutsche Bank AG	1.1	1	4.1	8.7	12.5
	ABN-AMRO Holdings NV	20	22.1	27.2	29.1	24
	BANCO Santander C. HISP	11.6	10.8	11.6	9.4	15.8

Source: Table prepared by author from figures of Standard & Poor's.

2-2. Types of Organizational Structure

Group under Holding Company Structure

Among European large diversified financial conglomerates, Credit Suisse, ING and HSBC group adopted, for different reasons, the holding company structure. Recently, however, Credit Suisse changed its structure to that of universal banking.

Group under Universal Bank Structure

Deutsche bank and UBS have kept to the universal bank structure by emphasizing the balance between centralization and decentralization.

2-3. Case Study of Major European Financial Conglomerates

2-3-1 Credit Suisse Group

History

In 1988, Credit Suisse took a controlling stake in The First Boston Corporation, one of the leading investment banks in New York. In 1996, the Credit Suisse group became a holding company of Credit Suisse and Credit Suisse First Boston. It merged with Winterthur under the holding company structure in 1997. In 2000, Credit Suisse First Boston (CSFB) announced the acquisition of the US-based investment bank and corporate bond specialist, DLJ. By 2003, the CSFB-DLJ deal was widely perceived as failed.[38] CSFB was involved in many Wall Street scandals and lost $1.2 billion in 2002.

Originally, the group was organized under a holding company owning three different legal entities: Credit Suisse in private banking, CSFB in investment banking and Winterthur in insurance. This was to decentralize operations depending on the nature of business culture, compensation structure and historical background of each entity.

Organization

After 2006, the group launched Credit Suisse as a new organization, an integral global bank combining its private banking and commercial banking arm with CSFB's investment banking arm for more centralization and overseeing of businesses. In part, this reorganization was a response to various irregularities in the investment banking unit.

Credit Suisse is structured into three global divisions:

1. Investment banking;
2. Private banking and asset management; and
3. Insurance business operated by Winterthur independently within Credit Suisse.

Figure 6 Credit Suisse Group Organization (October 2006)

	Credit Suisse Group		
Banking	Banking	Banking	Insurance
Investment Banking	Private banking	Asset Management	Winterthur

Source: <http://www.cresit-suisse.com/en/who-we-are/>.

In investment banking, Credit Suisse offers securities products and financial advisory

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[38] Geisst (2004), p. 63.

services to corporations, governments and institutional investors. In private banking, it provides comprehensive advice and a broad range of investment products and services tailored to the complex needs of high-net-worth individuals. In its asset management business, it offers products across the full spectrum of investment classes, ranging from equities, fixed income and multiple-asset class products, to alternative investments such as real estate, hedge funds, private equity and volatility management. The asset management business of Credit Suisse comprises of a number of legal entities around the world that are subject to distinct regulatory requirements.

Management Structure

The most senior executive body of the Credit Suisse group is the Group Executive Board. It is responsible for the day-to-day operational management of the group as a whole and the implementation of the principal business strategy and the financial plans approved by it. It coordinates significant group-wide initiatives, projects and business developments and establishes general group-wide policies.

The most senior executive body of the banking organization is the Executive Board. It is responsible for the day-to-day operational management of the Group's banking business. It develops and implements strategic business plans for the bank, subject to approval by the Board, and reviews and co-ordinates significant initiatives and projects in the divisions and regions or in the Shared Services functions.

The Group Executive Board consists of eight members lead by the CEO of the Credit Suisse group. Other members are the Chief Financial Officer, the Chief Risk Officer and General Counsel of the Group and CEOs of the four strategic divisions, i.e., private banking, asset management, investment banking, and Winterthur, the insurance arm of the group.

Before the reorganization, board members numbered 13 of which six were from investment banking. The change shows the strategic focus on private banking and asset management, which are more stable sources of income for the group. Members of the Executive Board are identical other than the Winterthur CEO with the addition of the Chief Information Officer.

Summary

Credit Suisse moved from a holding company structure to the typical European universal banking organization, consolidating investment banking under its banking arm. In the holding company structure, it was apparent that the independent and decentralized investment banking arm sometimes goes too far, becoming difficult to control for its European headquarters, with former CSFB causing several problems with regulators in countries like the US and Japan. The group now developed coordinated management systems between retail, private and investment banking under the universal bank structure.

The insurance business acquired in 1997 has not performed well as yet, suggestingt that little synergy has been achieved between banking and insurance businesses.[39]

[39] *Credit Suisse Annual Report* (2004).

2-3-2. ABN-AMRO Holdings

History

In 1991, two large commercial banks, Algemene Bank Nederland (ABN) and Amsterdamche-Rotterdamsche Bank (AMRO) merged to become the ABN-AMRO Bank.

ABN-AMRO is one of the most profitable global financial conglomerates focused on regional middle markets for consumers and commercial clients. Bank emphasis is on three home markets, i.e., the Netherlands, the US and Brazil. In the US, it operates through LaSalle bank, a well-established middle market commercial bank headquartered in Chicago. In Brazil, the main bank operation is Banco Real. In 2005, ABN-AMRO acquired Banca Antonveneta of Italy, the fourth home market.

Organization

ABM-AMRO adopts the business unit structure to decentralize business decisions to do with the clients of each unit. These units are responsible for managing a particular region, client segment or product segment, while also sharing expertise and operational excellence across the group.

There are a total of seven client business units. Five are regional client business units, namely, the Netherlands, Europe, North America, Latin America and Asia. Two are global client business units serving 550 multinational corporate clients and private clients, providing banking services to wealthy individuals and families.

In order to provide products to these client-based business units, there are three product business units: Global Markets, Transaction Banking and Asset Management. Global Markets develops products for commercial clients across the globe. Transaction Banking deals with product organization covering payments and trade in the bank for retail, private clients, and commercial markets. Asset Management manages assets for private investors and institutional clients.

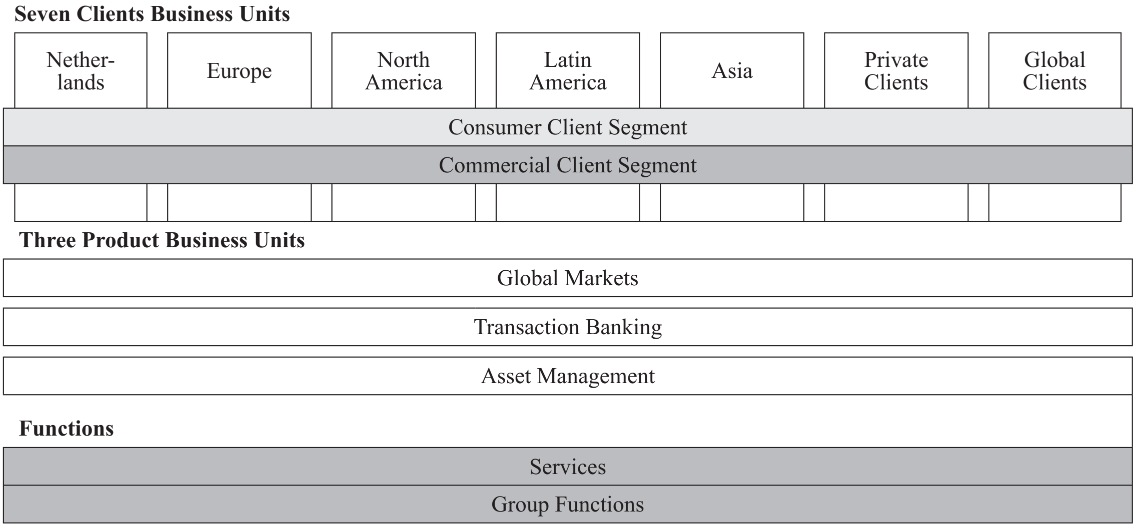
Centralized functional purposes are the Service Function and Group Function. The Service Function was established to create cost savings through consolidation and standardization. It focuses on further exploiting new market solutions for support services with the aim of providing better products and services for clients at lower costs. According to an officer with ABM-AMRO's US operations, IT services were consolidated by absorbing the best practices of an acquisition.[40] ABM-AMRO is strong in consolidating various service activities and cost cutting by improving operations.

Group Functions collaborates with the business units, maximizing client and shareholder value. Its basic functions are governance, standard and policy setting, and sharing expertise across the company.

To provide all clients with even better products and services, there are cross-business units named the Consumer Client Segment and the Commercial Client Segment. These segments focus on aligning client business units with product business units, sharing the best practices and exchanging winning formulas across the group in order to deliver high-quality solutions to client bases across the world.

[40] Information from former office of ABM-AMRO Chicago (US headquarters); October 26, 2006.

Figure 7 Group Organizational Structure of ABM-AMRO (as of January 2006)



(Source: ABM-AMRO Annual Report 2006, page 13.)

<u>Summary</u>

The Dutch have been leaders in global trade and finance since the sixteenth century with Dutch financial conglomerates having the managerial advantage to run globalized organizations. As the ABN-AMRO structure shows, its success lies in the balance between decentralization and centralized coordination of functional activities as well as of products. This kind of a matrix-type organization with business units is difficult to manage and one needs to take a closer look at the daily management of ABM-AMRO.

2-3-3. ING Group

<u>History</u>

Internationale Nederlanden Group (ING) was founded in 1991 by a merger between the insurance company Nationale-Nederlanden and the banking company NMB Postbank Group to create the first bancassurer[41] of the Netherlands.

The founding of Internationale Nederlanden Group was facilitated in 1990 when legal restrictions on mergers between insurers and banks were lifted in the Netherlands. The market soon abbreviated the name to ING with the company following suit by changing the statutory name to ING Groep NV. ING has since developed from a Dutch company with some international business to a multinational with Dutch roots. This was achieved through a mixture of organic growth, such as the creation of ING Direct from scratch, as well as various large acquisitions.

The first large acquisition took place in 1995, when ING took over Barings Bank, increasing the brand recognition of ING around the world and strengthening its wholesale banking presence in emerging markets. Some of Barings' activities were integrated in ING's business units, while other sections were closed down or sold.

During its short existence, ING has grown into a global financial conglomerate combining banking, insurance and asset management.

[41] Financial institution which has banking and insurance under the same arm.

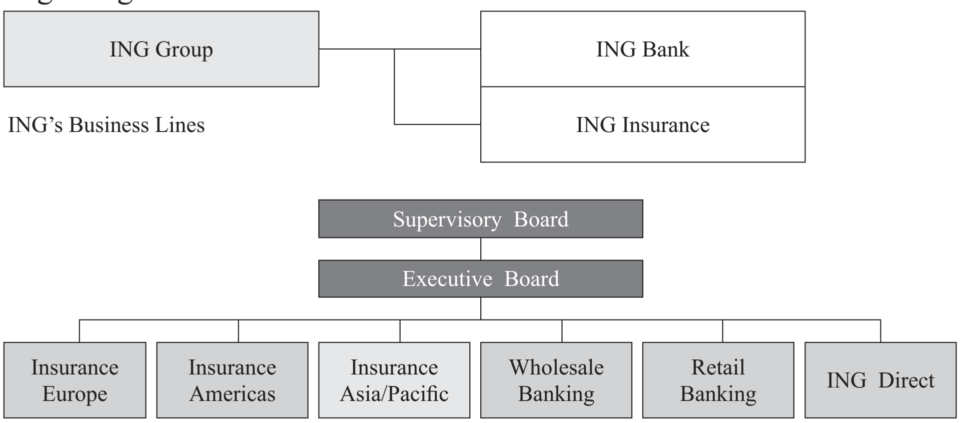
Organization

The ING group adopted the holding company structure because under Dutch law it is prohibited to conduct insurance business and banking business under the same entity.

After organizational restructuring in 2004, the group was divided into six business units according to their business, customer and region (in the case of insurance). The daily business was run by these decentralized units. The profits of the group come from the insurance business (51%) and the wholesale banking business (25%).

Figure 8 ING Group Organization Chart (October 2006)

Legal Organization



Source: <www.ing.com/group/showdoc.jsp?docid=092825-EN&menopt=abo%7Cfct>.

Management Structure

The group is run by an eight-member executive board consisting of the CEO and Chairman, the Chief Financial Officer and Vice-Chairman, and six members identical to those heading each business unit, i.e., Wholesale Banking, ING Direct, Retail Banking, Insurance Americas and ING Investment Management in the Americas, Insurance Asia/Pacific and ING Investment Management Asia/Pacific, and Insurance Europe and ING Investment Management Europe. This management structure is unique because the membership covers strategic business units as well as regional responsibilities. ING's core business is insurance and investment management in the global market and domestic retail.

Summary

As with ABN-AMRO, the ING group adopted the holding company structure in order to combine various acquisitions. For efficient management, ING and ABM-AMRO assumed the business unit structure in order to decentralize daily decision-making. It is interesting to note the similar basis for business unit categorization in both companies.

2-3-4. RBS Group

History

The Royal Bank of Scotland (RBS) Group grew through merger and acquisition. The Royal Bank of Scotland itself was founded in Edinburgh in 1727. For several decades it traded solely from its head office, but in 1783 it opened its first branch office in Glasgow. It went on to develop a large network of offices throughout Scotland during the nineteenth century. In 1874, it opened a branch office in London and from the 1920s developed, by acquisition, a major presence in England.

During the 1980s the Group diversified, setting up an innovative car insurance company, Direct Line, in 1985, and acquiring Citizens Financial Group of Rhode Island, USA in 1988. During the early 1990s, the Royal Bank refocused on its core business of retail banking, acquiring the private bank of Adam & Company (established 1983) in 1992. It launched Direct Banking in 1994, which quickly became Britain's fastest growing twenty-four-hour telephone banking operation. In 1997 it announced the UK's first fully-fledged on-line banking service over the Internet, as well as joint financial services ventures with both Tesco and Virgin Direct.

In 2000, the Royal Bank acquired National Westminster (Nat West) Bank, in the biggest takeover in the history of British banking, to create a huge group. After the merger of the Royal Bank and Nat West, the businesses of the two groups were combined, including integration of their IT systems. Nat West's retail bank continues to operate as a distinct and separate brand.

Group Structure

The RBS Group is made up of eight divisions which in turn incorporate over 41 brands:

- The Royal Bank Scotland Retail Banking;
- NatWest Retail Banking;
- Wealth Management;
- Direct Channels;
- Corporate Markets;
- RBS Insurance;
- Ulster Bank Group; and
- Citizens Financial Group.

The RBS Group, under the Group Chief Executive, is structured into the operating areas depicted in Table 6 below. These operating areas are either former legal entities acquired but run independently, or newly created subsidiaries and divisions. Although there will be synergy between the different businesses under the same division because of shared management, it seems impossible to have group-wide synergy. RBS is a global united brand, but operates in retail markets under the previous names of acquired banks such as NatWest and Citizens.

Table 6 RBS Group Divisions and Management Structure

Division	Businesses	Divisional Heads
Retail Banking The Royal Bank of Scotland NatWest	Personal Banking Small Business Private Banking Royal Scottish Assurance NatWest Life	Executive Chairman, Retail Markets
Wealth Management	Royal Bank of Scotland International NatWest Offshore	Executive Chairman, Retail Markets.
Retail-Direct Channels	The One Account Tesco Personal Finance E-Commerce and Internet Cards Business Own Brand Businesses Comfort Card Kroger Personal Finance	Executive Chairman, Retail Markets Chairman, Retail Direct Chief Executive, Retail Direct
Corporate Markets	Corporate RBS Financial Markets Lombard Specialist Businesses	Chairman, Corporate Markets Chief Executive, Corporate Markets
RBS Insurance	Direct Line Churchill Privilege Green Flag UKI Partnerships	Chairman, RBS Insurance Chief Executive, RBS Insurance
Ulster Bank Group	Ulster Bank First Active	Group Chief Executive, Ulster Bank Group
Citizens (USA)	Personal Business Corporate	Chairman, President & CEO, Citizens Financial Group

Source: Table prepared by author from RBS homepage data.

<u>Summary</u>

The RBS group's merged banks run independently according to their respective regional territory. The author of this paper heard from a senior risk officer in the group's US operation that all corporate and market activities are independent from the RBS head office. The officer had never seen the management from the head office in Scotland pay a visit to their US office. Risk control of the US operation is emphasized and there are some synergies between the US capital market and the European capital market group. Other than that, the US operation is run independently.[42] Thus, RBS emphasizes the independent operation of former entities but integrates the corporate identity of RBS,

[42] Heard from Ed Fogel, Head of Compliance, RBS Greenwich Capital Markets; October 10, 2006.

risk control and IT operations.

2-3-5. HSBC Group (UK)

<u>History</u>
The Hong Kong and Shanghai Banking Corporation (HSBC) was established in 1865 to finance trade in the Far East. In 1991, its headquarters in Hong Kong were moved to London and it soon acquired Midland Bank plc, Crédit Commercial de France (CCF) and Household Finance, becoming the largest financial conglomerate in Europe. Under its holding company, HSBC Holdings in the UK, it holds regional independent banking subsidiaries as well as operational subsidiaries in all kinds of non-bank areas including Investment Bank, Asset Management, Investment Management, Private Banking, Securities and Insurance businesses. Each group company runs independently under the united brand of HSBC.

<u>Organizational Structure</u>
HSBC Holdings is a public limited company incorporated in England and Wales and headquartered in London. To promote the Group as a whole, HSBC was established as a uniform, international brand name in 1999. In 2002, HSBC launched a campaign to differentiate its brand from those of its competitors by describing the unique characteristics which distinguish HSBC, summarized in the words “The world's local bank”.

References to HSBC designate the HSBC Group of discrete legal entities, each of which is wholly or partly owned by HSBC Holdings plc.[43]

Figure 9 HSBC Group Organization (Major Subsidiaries as of October 2006)

- HSBC Holdings plc (UK)
  - Hong Kong & Shanghai Banking Corp. Ltd. (Asia)
  - HSBC Bank plc (UK)
  - Hang Seng Bank (HK)
  - HSBC France (formerly CCF S.A.) (France)
  - Household International Inc. (USA)
  - HSBC Bank USA N.A. (USA)
  - SBC Bank Brazil S.A. - Banco Multipo (Brazil)
  - HSBC Private Banking Holdings (Suisse) S.A. (Suisse)
  - Grupo Financiero HSBC, S.A. de C.V. (Mexico)

Source: <http://www.hsbc.com/hsbc/about_hsbc/group-structure>.

The holding company structure with decentralized operations fits the management functioning of the group, which has expanded through mergers and acquisitions.

[43] “HSBC Group Structure,” <http://www.hsbc.com/hsbc/about_hsbc/group-structure> (accessed October, 2006).

Summary

Like the RBS group, HSBC is a holding company which unites the various global companies which it has acquired. The logo of HSBC is a symbol of unity for the group, but the acquired firms are run independently with a focus on the local market through decentralization, making each operating bank and other subsidiaries profitable.

2-3-6. Deutsche Bank AG (Germany)

History

Deutsche Bank was founded in Berlin in 1870 to support the internationalization of business and to promote and facilitate trade relations between Germany, other European countries, and overseas markets. The bank has developed into a leading global provider of financial services by merging with British merchant bank Morgan Grenfell in 1989 and US wholesale bank Bankers Trust in 1999.

Organization

Historically, Deutsche Bank followed the universal bank structure with centralized decision making. After merging with Morgan Grenfell and Bankers Trust, it established its investment banking headquarters in London while its commercial banking remained in Germany. This was done to achieve efficient management in a different culture.

Deutsche Bank comprises three Group Divisions: Corporate and Investment Bank (CIB), Private Clients and Asset Management (PCAM) and Corporate Investments (CI). Responsibility for the operational management of the group‘s core businesses lies with the respective Divisional Committees.

The Management Board of Deutsche Bank AG has as its prime responsibility the strategic management, resource allocation, financial accounting and disclosure, risk management and control of the Group. The board members are the Chairman, Chief Credit Officer, Chief Administration Officer, Chief Financial Officer and Chief Operating Officer.

Group-wide strategic decisions are made by the group executive committee, comprising the members of the Management Board, Business Heads of the Group Divisions, and Regional Heads. The committee reviews the development of the businesses, discusses matters of Group strategy and prepares recommendations for final decision by the Management Board.

Group head office activities are divided into eight functional committees.

Figure 10 Deutsche Bank Management Structure

Management Board Chairman/Chief Credit Officer/Chief Administration Officer/Chief Financial Officer/ Chief Operating Officer		
Group Executive Committee Members: Managing Board Members/Business Heads/Regional Heads		
Group Divisions		
Corporate and Investment Bank	Corporate Investments	Private Clients and Asset Management
Head Office Functional Committees Capital and Risks/Compliance/Finance/Human Resources/Investment/ IT and Operations/Principal Investment Commitment/Risk Executive		

Source: <http://www.db.com/en/content/print_version.htm>.

Summary

During the 90s, the bank focused on global investment banking activities. Its performance deteriorated and stock price declined (Table 5). This case is cited as a typical example of the failure of global diversifications into investment banking by a large commercial bank. Banks which succeed in diversification are more likely to have been based in Switzerland, the Netherlands and UK, while those based in Germany and France are less successful. These results show that it is very important to have cultural, historical and language capabilities to manage globally diversified financial conglomerates.

2-3-7. UBS AG

UBS AG, formed through a merger of the Union Bank of Switzerland and the Swiss Bank Corporation in June 1998, is typical of a universal bank with its headquarters in Switzerland and most of its major activities in global markets. It is the world's largest wealth manager, a top tier investment banking and securities firm, and a key global asset manager. In Switzerland, UBS is the market leader in retail and commercial banking.

UBS has more than 140 years of experience in wealth management, and is the largest wealth manager in the world. Its investment banking headquarters are in London and New York. It is organized into distinct areas of equities, namely, fixed income rates and currencies, and investment banking.

History

Swiss Bank Corporation (SBC) was founded in 1872, and traded as a universal bank with domestic corporate and retail clients and asset management. Abroad, however, it concentrated mainly on commercial banking for corporate clients. In the last decade of the twentieth century, SBC strengthened its international orientation by taking over foreign finance firms O'Connor & Associates, Chicago; Brinson Partners, Inc., Chicago; and S.G. Warburg plc, London.

Union Bank of Switzerland, created in 1912 by the merger of two regional banks, was typical of universal banking, dealing with corporate and retail clients and asset management at home and with commercial banking for corporate clients abroad.

On July 1, 1998, the merger between the Union Bank of Switzerland, Zurich and Swiss Bank Corporation, Basel was completed to form UBS AG.

On November 3, 2000, UBS AG merged with New York's PaineWebber Inc., a full-service securities firm.

Organization

The UBS group directly controls 35 acquired firms as divisions or subsidiaries. The group's activities are divided into four business divisions: Global Wealth Management and Business Banking, Investment Banking, Global Asset Management and Corporate Center. Its focus is in Investment Banking and Wealth Management and pursuing synergies across the division. UBS utilizes human resources from acquisitions effectively and the global integration is working efficiently compared to that of other European conglomerates (Figure 12).

Figure 12 Organizational Structure of the UBS Group (October 2006)

Source:<www.ubs.com/1/e/media-overview/media-switzerland/ourbusinesses.html>.

The Group Executive Board (GEB) has executive management responsibility for the Group and is accountable to the Board for the firm's results. The GEB, and in particular the CEO, is responsible for the implementation and results of the firm's business strategies, for the alignment of the Business Groups to UBS's integrated business model and for the exploitation of synergies across the firm. The GEB fosters an entrepreneurial leadership spirit throughout the firm. Together with the Chairman's Office, the GEB assumes overall responsibility for the development of UBS's strategies.

The GEB members are Group CEO, Deputy Group CEO, Chairman and

CEO of Global Wealth Management and Business Banking, Chairman and CEO of Investment Banking, Chairman and CEO of Global Asset Management, Group General Counsel, Group Chief Financial Officer, Group Chief Risk Officer, Chairman and CEO of Americas, Chairman and CEO of Asia Pacific, and Head of Wealth Management International.

Summary

UBS is a well managed, globally diversified financial conglomerate with stable investment banking and wealth management businesses. The group is well suited to absorb firms with a different culture, utilizing their strengths. The universal bank structure helps integrate these highly sophisticated financial businesses. The group's focus on investment banking outside Switzerland helps it to manage difficult operations smoothly.

2-4. Findings from European Conglomerates

2-4-1. The Future of UK's Four Large Commercial Banks

It is interesting to contemplate the future of UK's four major clearing banks: Lloyds, Midland, Barclays and Nat West.

Lloyds merged with TSB and now, TSB Lloyds is the largest domestic retail focused bank.

Midland was acquired by HSBC group and renamed HSBC UK.

Nat West had major problems in their investment banking business in late 90s. Nat West was acquired by RBS and is now one of the RBS Group's banks.

Though Barclays, too, had problems like Nat West, it is the only bank to have survived without being merged or acquired.

In the UK, there is a clear cultural and career difference between commercial banking and investment banking. There is even a class difference, with those at commercial banks being high school graduates and those in investment being British university graduates. Commercial bank managers were not equipped with the tools required for risk control and management of investment banking. The diversification and transformation of traditional British banks into universal banks called for qualified management capability to manage the newer, more complicated institutions.

2-4-2. Big Bang and London as Wimbledon of International Finance

London's financial industries owe their prosperity to foreign talent and foreign capital. In 1986, Margaret Thatcher implemented the London Stock Exchange reform known as the Big Bang. Minimum commissions and restrictions in the stock market, in addition to the already developed Euro-Dollar market with international banking activities, attracted many foreign financial institutions. In this environment, traditional British jobbers, brokers and merchant banks were replaced and London became the true center of world finance with dominance in international equity underwriting and trading, foreign exchange trading, derivative trading, and hedge funds.

Table 7 Latest Shares in the London Financial Center

	Britain	US	Japan
Cross-border bank lending	20	9	8
Foreign equity trading	40	34	-
International bond trading	70	Na	Na
Foreign exchange trading	32	18	8
OTC derivative trading	43	24	3
Hedge fund assets	21	66	2

Source: The Economist, 21 October 2006.

In 2006, the London Stock Exchange had 172 international listings, compared with 134 listings at the more regulated New York Stock Exchange.[44] Instead of protecting domestic financial institutions, the prosperity of London's financial center came about by inviting global major players including financial conglomerates to London, with the city coming to be known as the Wimbledon of international finance. Global financial institutions in London are run in the US management style and about 30% of professionals working here are Americans.[45] This underlines the strength of American-style management in a global competitive market.

2-4-3. Country Managerial Advantage

In general, those firms headquartered in historically globalized countries run their organizations well; while the performance of those headquartered in the European continent is not so good. Further analysis is required as to the difference in performance and whether it stems from management or the organizational setup.

In Europe, banks headquartered in Switzerland, UK and the Netherlands performed better than others. This may be due to managerial capabilities developed through long experience in running international businesses. Though England, too, has similar such managerial capability, it has failed to run large financial institutions with the top players now being from Scotland and Hong Kong.

3. Information Gained from the Experiences of US and European Conglomerates

3-1. Formal Structure and Actual Organization

The organizational structures of major US and European conglomerates, including those of the cases analyzed earlier, are summarized in Table 8, below.

The structure of each firm varies, differing from country to country and according to the characteristics of a particular business as well as its products. Many European banks adopted the universal bank structure. However, most US financial conglomerates adopted the holding company structure. For legal purposes, the firm established a business subsidiary or business holding company under the pure holding company.

In actual business implementation, both firms with the holding company structure and those with the universal bank structure divide their business into more

[44] The Economist, October 21, 2006.
[45] The Economist, October 21, 2006.

than three decentralized strategic business units or divisions. Each unit or division is run by a division head and managed like an independent company with an independent performance review, capital and resource allocation as well as risk assessments. The headquarters of the group as a whole is separate, having centralized financial and operation control, as well as technology, legal and compliance services. The group executive committee, headed by the CEO of the group, is comprised of the head of each business division, as well as heads of corporate centers like the Chief Financial and Chief Administration Officers.

The legal structure of these organizations fulfills legal requirements, while the actual divisional organizations and the balance of centralization and decentralization are more important for a good business performance record.

Table 8 Organizational Structure of Major Financial Conglomerates in the US and Europe (May 2005)[46]

Country	Group	Structure	Major Subsidiaries and/or Business Divisions
US	Citigroup	FHC	Global Consumer, Corporate & Investment Banking, Global Wealth Management, Alternative Investment.
	JPMorgan Chase	FHC	Investment Banking, Retail Financial Services, Card Services, Commercial Banking, Asset & Wealth Management, Treasury & Securities Services.
	Bank of America	FHC	Global Consumer & Small Business Banking, Global Wealth & Investment Management, Global Business & Financial Services, Global Capital Markets & Investment Banking.
UK	HSBC	HC	The Hong Kong & Shanghai Bank (HK), HSBC Bank (UK), CCF(France), Household (US).
	Royal Bank of Scotland Group	HC (Divisional)	RBS Retail Banking, NatWest Retail Banking, Wealth Management, Direct Channels, Corporate Markets, RBS Insurance, Ulster Bank Group, Citizens Financial Group.
	Barclays Bank	SBU	UK Banking, Global Retail & Commercial Banking, Barclays Card, Barclays Capital, Barclay Global Investors, Barclays Wealth Service.
Germany	Deutsche Bank AG	UB (Divisional)	Corporate & Investment Banking, Private Clients & Asset Management, Corporate Investment.
Switzerland	Credit Suisse	UB/HC	Investment Banking, Private Banking, Asset Management, Winterthur.
	UBS	UB (Divisional)	Global Wealth Management & Business Banking, Investment Bank, Global Asset Management, Corporate Center.

[46] Information obtained from the homepage of each group.

The Nether-lands	ING	HC (Business Units)	US Insurance, Europe Insurance, Asia Insurance, Wholesale Banking, Retail Banking, ING Direct.
	ABN-AMRO	HC (Business Units)	Matrix of Seven Client Business Units and Three Product Business Units.
France	BNP Paribas	UB (Divisional)	Corporate & Investment Banking, Retail Banking, Asset Management, Security Services.
Spain	Banco Santander	Matrix	1st Level: Continental Europe, UK, Latin America. 2nd Level: Retail Banking, Asset Management & Insurance, Global Wholesale.

Note: FHC = Financial Holding Company, HC = Holding Company, UB = Universal Bank, SBU = Strategic Business Unit.

3-2. Problems of Financial Conglomerates

Difficulties of Managing Financial Conglomerates

It is important to understand that there are considerable managerial difficulties in operating large diversified financial conglomerates. Case studies show that often institutions were too large to manage, with immense problems, scandals and losses being incurred. US financial conglomerates may have the competitive advantage in running these conglomerates because of a combination of various factors. These advantages were created by talented leadership managing their institutions with good governance. However, the factors seem America-specific and difficult to replicate elsewhere.

Besides, a history of experienced management and infrastructure are important for the efficient running of large globalized financial institutions. Thus, all aspects should be assessed carefully before being applied to Japan's managerial systems and to those of other Asian financial institutions.

Too Big to Manage

It is seen that at some point of growth, a financial institution becomes inefficient and difficult to manage. The cost of the organization becomes much larger than the economy of scale and scope. A bank's main asset is its human resources and the costs to manage these resources are huge.

Synergy Management

There are three types of synergies in financial conglomerates: synergy among retail business, synergy among wholesale business, and synergy between wholesale and retail business.

Case studies of US firms show that the first type of synergy has been achieved successfully because of cross-sell, working well with the strong nationwide retail and distribution network provided.

To a lesser degree, good synergy is achieved within the wholesale business by selling different types of services and products to corporate customers. Large commercial banks with a good customer base have this advantage, and can realize synergy in this area.

However, no firm was successful in creating synergy between wholesale and retail businesses. The difference of culture and compensation systems makes this difficult to achieve.

Conflict of Interest Issues

Conflict of interest issues are inherent in diversified financial institutions because of the focus of different divisions with profit-making being the priority. In the US, the conflict between investment bankers and stock analysts becomes a major issue because an analyst's compensation is determined by the amount of transactions achieved in one's industry field. The analysis is favorable for those companies whose investment bankers are pursuing underwriting businesses.

Another major conflict area is that of retail brokers at banks. At many financial conglomerates, retail brokers share offices with retail banking branches. Some retail bank salespeople, to earn commission, sell their affiliate brokers investment products. In the US, there is a concern that retail bank customers do not know the difference between keeping their money in safe bank deposits and applying it to roller-coaster investment products. According to the Wall Street Journal,[47] the National Association of Securities Dealers, the brokerage industry's self-regulatory group, is worried that brokers based in bank branches are not doing a good enough job of informing customers that their investments, unlike bank deposits, carry risks of loss. This issue becomes bigger in the US where more banks have diversified into security businesses.

Difficulty of Managing Investment Banking

Through mergers and acquisitions, many US commercial banks acquired investment banking businesses. However, many problems arose due to the difficulties of managing these businesses. Investment banking needs a flat, decentralized, organic and self-designing organization with an entrepreneurial culture which induces good performances. These factors are contradictory to those of traditional commercial banking which is based more on a bureaucratic organization. Thus, when entering into new activities, it is important for traditional commercial banks to change their culture and incentive systems, making adjustments in their organizational, compensation and control structures.[48] As mentioned earlier, the top management of financial conglomerates is faced with two challenges, one from shareholders and the other from star players who stay loyal for profits, not to the firm per se.

3-3. Importance of Managerial Capabilities

Effective and efficient management is crucial for the functioning of a financial conglomerate whose operations are complicated and vast in scale. Again, as mentioned earlier, financial firms in the US have the advantage of a good market of senior and middle management. The multi-divisional nature of these firms encourages the growth

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[47] James Levy, Pessin. "Concern over Brokers at Banks". The Wall Street Journal, October 28, 2006.
[48] Rajan (1996).

of managerial talent with each division being managed like an independent financial firm on a smaller scale.

3-4. Implications for Japan and Asia

It is difficult to conclude that the US conglomerate management model, although performing well, is the most suitable model for Japanese and other Asian firms to replicate. This is because of the difference in competitive and regulatory environments as well as the organizational culture, compensation systems and leadership effectiveness.[49] It may be possible to change some aspects but not all. It is a combination of all these factors that explains the management strength of a US financial conglomerate.

As discussed earlier, case studies of European financial firms show that a history of experienced management and infrastructure is important for the efficient running of large globalized financial institutions. Thus, it cannot be emphasized enough that every aspect should be assessed carefully before being applied to Japan's managerial systems and to those of other Asian financial institutions.

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[49] Mishikin (2006) shows us that institutional development is a complex process, and the "one size fits all" approach of trying to replicate institutions from advanced countries in poorer countries has not worked, and that institutional framework must be homegrown.

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