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1

The Excellent Banks

'Could you suggest the names of about 10 banking institutions whom you regard as the best managed in the business, regardless of size, location or business profile?'

This was the question we posed in late 2003 to about 15 leading banking consultants, buy- and sell-side analysts, and specialists in rating agencies. We call these individuals 'bankologists'; they are people who have spent most or all of a long career studying banks across the sector and making their living by providing independent, thoughtful insights to their clients. We made no effort to define further what we meant by 'best managed', although the phrases 'best practice', 'best of breed' and 'best positioned' often came up in the ensuing discussion. In effect, we found that most of the 10 who ultimately accepted the challenge had their own selection process: banks they knew well and admired, others which they knew less well but which had distinguished themselves against their peers over a period of decades, and some which represented a reasonable selection of geographies and business models. Some had difficulty identifying ten banks, while others went on at some length!

From the lists provided, we identified ten banks which received at least a substantial minimum of votes from the ten panellists (essentially the same methodology used in the two previous excellence in banking books written in the 1980s). As our goal is not to award prizes, but rather to shape a collective view of best management practice in the banking world, we have not identified the scores for each bank.

2 *Excellence in Banking – Revisited!*

Are there more intellectually satisfying means of selecting the best managed banks in the world? Most panellists felt that our ad hoc approach was the only realistic one. Others, however, pointed out that past financial performance, usually as measured by the increase in stockholder value (generally defined as the stock price movement plus dividends per share), over a reasonable time period is the only true benchmark.

Most of our panel, however, questioned this approach. It relies heavily on the start date chosen for the data series, but more importantly reflects only past performance as determined by the stock market. It is thus in effect driving with the rear-view mirror, while our focus is on today's profile of excellence and the superior results one might obtain in the future. As pointed out by one of our panellists, a leading sell-side analyst:

'Excellent management doesn't necessarily reflect the best stockholder value. What the investor wants is high ROE [return on equity] and earnings growth; share performance comes afterward!'

Another approach is to take the individual ratings awarded by the major rating agencies: the perceived risk of the bank as a stand-alone institution without considering possible support from regulators and others. This was clearly the starting point for the rating professionals in our panel, yet we sensed that even in these cases the individual involved was injecting his own personal views as well.

On balance, given our objectives we feel the method chosen is as good as any alternative. There is no magic in the number of banks chosen (nine), yet this provides a sample of banks based in the key geographical areas of the USA and Europe as well as three of the major categories into which analysts are increasingly segmenting the banking world: truly global institutions with a universal product range, commercial banks in major national markets, and monoline or specialist investment banks.

What is missing from our sample is the vast universe of smaller, locally-based banks which fall off the radar screen of our panellists. This is understandable given their perspective of serving major investors with minimum size criteria, but it is nevertheless a flaw in the selection process. In Chapter 11, however, we make an attempt

to redress the balance by pointing out how, in aggregate, such banks can demonstrate truly superior earnings performance, customer service and management quality.

One can also regret the absence of banks based outside the USA and Europe. Several of our panellists suggested leading banks in Korea, Australia and Brazil, but sadly none of them won a substantial minority of the overall votes.

One can also debate the inclusion of pure or monoline investment banks in our sample. In the 1980s excellence books, our panellists largely ignored them as being outside the banking world. As portrayed in Davis, *Investment Banking – Addressing the Management Issues* (2003) and countless other research efforts, however, the pure investment banks are very much a part of this world today.

To summarize the selection process, we repeat the objective of the exercise. It is not to award prizes or predict future financial performance but rather to establish an interview sample which, however imperfect, can reasonably be expected to offer useful insights into the management issues currently being faced by leading banks, the solutions which are being applied to resolve them, and the possible outcome in terms of the future shape and profile of the business.

While our panellists did select ten banks on the basis described above, sadly we were not able to arrange interviews with one of them. The nine banks thus comprising our interview sample are listed in Table 1.1, along with a brief statistical profile. Appendix 1 offers a more detailed description of their history, business profile and financial record.

Our sample includes the two banks which are often paired together as rivals in the emerging segment of global/universal institutions: Citigroup and HSBC. UBS is widely seen as a European champion which may well join that select band.

In the category of leading regional commercial banks with essentially a national focus, our list includes Wells Fargo and Fifth Third in the USA as well as UniCredito, Banco Popular Español and Svenska Handelsbanken in Europe. And finally, Goldman Sachs represents the segment of specialist/monoline investment banks.

Figure 1.1 provides a different profile for our excellent banks. A well-established correlation exists between a bank's price/earnings ratio and its prospective return on equity. The higher the prospective

Table 1.1 The excellent banks: selected data as at December 2003

Segment	Institution	Equity (US\$ billion)	Number of employees (000s)	2004E ROE (%)	Price/ 2004E book	Projected annual EPS growth (%)	Market capitalization (US\$ billion)
Investment Banking	Goldman Sachs	22	19	14.8	2.08	7.7	50
Global Universal Banking	Citigroup	104	260	19.7	2.31	12.0	253
	HSBC	74	215	13.6	2.34	14.7	173
	UBS	28	67	20.9	2.78	17.0	91
Regional Commercial Banking	Wells Fargo	34	140	19.4	2.49	10.4	98
	Fifth Third	9	19	20.4	N/A	N/A	32
	UniCredito	10	69	19.7	2.08	11.3	34
	Banco Popular Español	3	13	23.8	2.97	11.2	14
	Handelsbanken	7	10	15.2	1.59	9.0	14

N/A = not available E = Estimated

EPS = Earnings per share

Source: UBS, DIBC calculations, company data, Citigroup

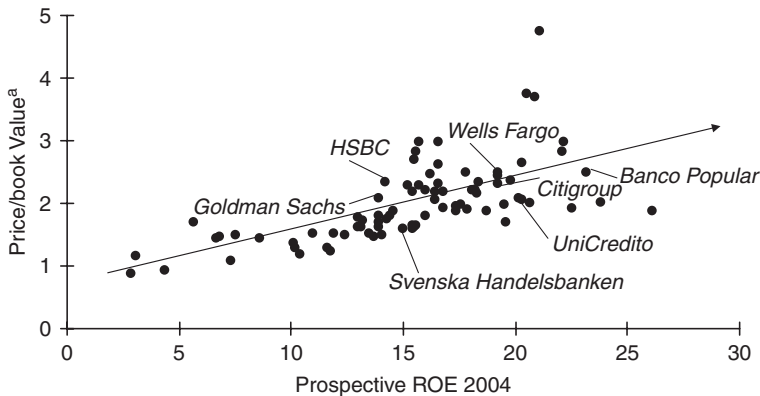
return, the higher will be the price paid over book value by investors. Figure 1.1 provides this key relationship for seven of our nine excellent banks as of the end of 2003.

Our excellent banks thus fit closely the trend or regression line linking price/book to projected ROE. Goldman Sachs, HSBC and Handelsbanken are close to the 15 per cent for the average bank in the global sample provided by UBS, while Wells, UniCredito, Citigroup and Banco Popular lie further out on the trend line.

Our interview process usually involved a day of in-depth, off-the-record, one-on-one conversations with three or four members of top management. We were thus fortunate to interview six Chief Executive Officers (CEOs) or Chairmen as well as other senior executives with responsibility for key functions such as retail banking, corporate and investment banking and human resources. Our interview approach was to start the dialogue with two questions to frame the subsequent conversation: what are the major management issues of concern to you, and how do you see the business of banking evolving in the next three to five years?

From this dialogue emerged what have become the headings for Chapters 3–10 which follow. Not all of our interviewees felt strongly about each of these topics, but enough did to merit a broader discussion. There is inevitably overlap between the chapters, and we

Figure 1.1 Prospective ROE drives stock valuation



^a end 2003 price divided by projected 2004 book value

Source: UBS data

could have aggregated several of them. Culture and people can arguably form part of a business model, for example, while the chapter on execution naturally relates to people, risk management and leadership. Yet we have tried to reflect as best we can the emphasis placed on the issues by our interviewees.

These interviews were supplemented by similar off-the-record conversations with members of our panel, other banking experts and senior bankers with a particularly interesting perspective on the issues involved. But before turning to these issues, let's take a few steps back in time to review the fate of our previous interview samples in 1984 and 1988.

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